INTERNATIONAL MONETARY FUND

Staff Country Reports

July 2004
IMF Country Report No. 04/226

Peru: Request for Stand-By Arrangement—Staff Report; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Peru

In the context of the request for a Stand-By Arrangement, the following documents have been released and are included in this package:

- the staff report for the request for Stand-By Arrangement prepared by a staff team of the IMF, following discussions that ended on **April 23, 2004,** with the officials of Peru on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on May 26, 2004.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a Press Release summarizing the **views of the Executive Board as expressed during its June 9, 2004 discussion** of the staff report that completed the request.

- a statement by the Executive Director for Peru.

The documents listed below have been or will be separately released.

Letter of Intent sent to the IMF by the authorities of Peru*
Memorandum of Economic and Financial Policies by the authorities of Peru*.
Technical Memorandum of Understanding*

*May also be included in Staff Report

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

PERU

Request for a Stand-By Arrangement

Prepared by Western Hemisphere Department
(In collaboration with other departments)

Approved by José Fajgenbaum and Juha Kähkönen

May 26, 2004

- ***Discussions***. Discussions on an economic program that could be supported by a new SBA were held in Lima during March 3–12, 2004 and completed at Headquarters during April 22–23. The staff team met with Minister of Finance Kuczynski, Central Bank President Silva Ruete, Minister of Energy and Mines Quijandría, Minister of Labor Neves, other senior officials, and private sector representatives. The staff team comprised G. Terrier (Head), A. López-Mejía, M. Rodríguez (all WHD), T. Dabán (FAD), and M. Shannon (PDR). J. Guzmán (Senior Resident Representative) assisted the mission. A. Wolfe (WHD), the outgoing mission chief, assisted the mission for the first few days of the discussions. Mr. Pereyra, Advisor to the Executive Director, participated in the policy discussions.

- ***Program.*** In their Letter of Intent dated May 25, 2004, the authorities describe their economic program for 2004–06 and request a 26–month SBA in an amount equivalent of SDR 287.3 million (20 percent of quota on an annual basis). The authorities intend to treat the SBA as precautionary. The program would be monitored under five semi-annual reviews. Quantitative performance criteria, as well as structural performance criteria and benchmarks, have been set for 2004.

- ***Expired Stand-By Arrangement (SBA) and Ex-Post Evaluation.*** The 2002–03 government's economic program was supported by a two-year SBA which expired on February 29, 2004. The arrangement was precautionary in nature, and total access equivalent to SDR 255 million (20 percent of quota annually). Performance under the SBA was satisfactory, and Peru did not make any drawings under the arrangement. In discussing Peru's longer term program engagement, Directors generally agreed that further Fund support for a strong precautionary program could be helpful, but emphasized the importance of an exit strategy from Fund-supported programs.

- ***Relations with the Fund.*** Peru's outstanding Fund credit is SDR 80.3 million (12.6 percent of quota). The last Article IV consultation was concluded on February 23, 2004. Peru has accepted the obligations of Article VIII, Sections 2, 3, and 4 and maintains an exchange system that is free of restrictions on payments and transfers for current international transactions. Peru's economic statistics are adequate for policy formulation, surveillance and program monitoring. Appendix V reviews data issues in more detail.

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EXECUTIVE SUMMARY

Background

- ***Performance under the 2002–03 SBA was satisfactory.*** This performance provides a solid basis for continuing with policies aimed at maintaining macroeconomic stability, further reducing Peru's vulnerabilities associated with high dollarization and public debt, and promoting private investment.

- ***In February 2004, the Executive Board endorsed the main findings of the Ex-Post Assessment of Peru's longer-term program engagement with the Fund.*** Directors urged continued implementation of prudent macroeconomic policies and adoption of structural reforms to improve prospects for broader-based output growth. Directors generally agreed that further Fund engagement in support of a strong precautionary program would be helpful, but emphasized the importance of defining an exit strategy from Fund-supported programs.

- ***The authorities are requesting a 26–month SBA covering the period through August 2006, when a new administration is scheduled to take office.*** They consider that continued Fund support for their program would help anchor economic policymaking and improve investor sentiment. The authorities do not intend to draw under this arrangement.

- ***The domestic political situation remains difficult.*** President Toledo's popular support is very low, and his government lacks a stable voting majority in congress.

Program objectives and staff appraisal

- ***Macroeconomic stability is at the core of the authorities' policies.*** To that effect, the program is based on continued gradual fiscal consolidation, keeping inflation low, and strengthening further official reserves within the inflation targeting regime.

- ***To boost economic growth and promote employment, the authorities are committed to implementing a broad set of structural reforms.*** Their program includes measures to foster private investment, improve resource management in the public sector, modify a costly preferential public pension regime (*Cédula Viva*), lower non-wage labor costs, strengthen the legal framework for decentralization, and reduce risks from dollarization further.

- ***The baseline medium-term outlook is favorable.*** Assuming sound macroeconomic policies and progress on structural reforms, economic growth under the program is forecast at 4½ percent a year for 2004–06. A possible free trade arrangement with the United States and the development of a second large natural gas project would be positive factors to the medium-term outlook.

- ***There are political risks to the program.*** Policy implementation could be hindered by a weakening of support in congress for the government's policies.

I. Background

1. ***Under the 2002–03 economic program, Peru made progress in stabilizing its economy and adopting growth-enhancing structural reforms.*** Economic growth averaged 4½ percent a year and inflation remained low under the inflation targeting framework. The combined public sector deficit was reduced from 2.3 percent of GDP in 2001 to 1.7 percent in 2003. Progress was also made in structural reforms, and vulnerabilities were reduced. Although risks associated with a relatively high public debt and financial dollarization still persist, substantial buffers have been built in recent years to mitigate financial vulnerabilities, including a high level of official reserves and a well-capitalized banking system.

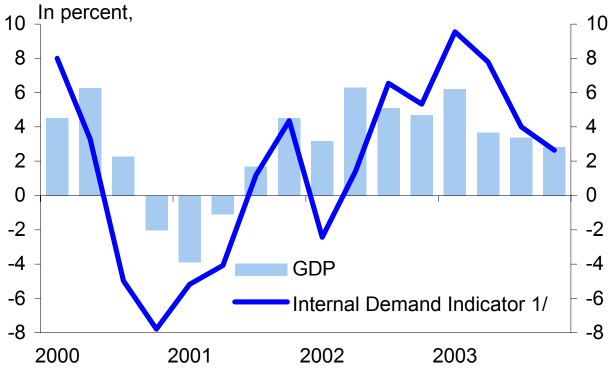
2. ***In February 2004, the Executive Board endorsed the main findings of the Ex-Post Assessment of Peru's longer-term program engagement with the Fund.*** Executive Directors considered that Fund involvement had been beneficial, with Fund-supported programs providing useful policy anchors and signals to official creditors and financial markets. Going forward, Directors generally agreed that Fund engagement in support of a strong program could continue to be helpful to solidify the consensus for sound policies and structural reforms in a challenging political environment. At the same time, they considered important to define an exit strategy from Fund-supported programs.

3. ***The authorities were in broad agreement, and considered that a new arrangement, treated as precautionary, would reinforce confidence and support continued implementation of prudent policies throughout the election period.*** This would then pave the way for an exit from Fund-supported programs. Accordingly, the authorities are requesting a new Stand-By Arrangement covering the period through August 2006, when a new administration is scheduled to take office.

II. Recent Developments

4. ***Output growth has remained robust and broad-based, but high unemployment and poverty have persisted (Box 1).*** During 2003, GDP grew by 4 percent in real terms (Table 1). The economy is expected to continue to gain momentum during the remainder of 2004, supported by export and investment, including the start of large-scale, import-substituting, gas project in the second half of the year. However, underemployment and unemployment have remained high, despite some improvement in urban employment in recent months. Total poverty is also high (at about 55 percent), with extreme poverty at around 25 percent.[1]

Figure 1. Economic activity



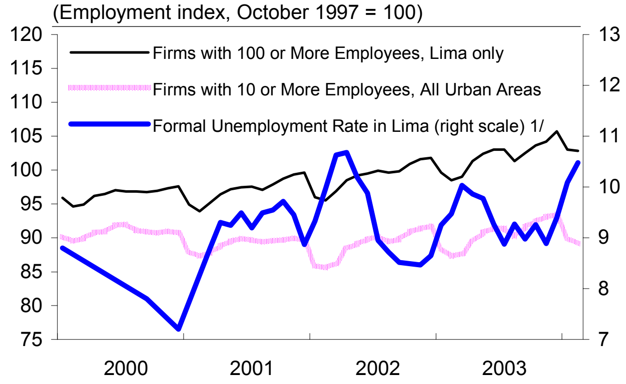
1/ BCRP indicator.

[1] The poverty rate is defined as the percentage of households whose total spending is below the cost of a basket of basic consumption goods, while extreme poverty is based on a consumption basket of basic food items only.

5. ***Inflation has picked up in recent months, primarily because of supply shocks, while the nominal exchange rate has remained broadly stable.*** At end-February, the 12–month increase in the CPI was 3.4 percent, at the upper end of the inflation target range (2.5–3.5 percent). Although inflation fell to 2.8 percent in April, the authorities expect it to return to the top of, or slightly above, the target range over the next few months. In their view, the pick up in inflation reflects in part a temporary decline in domestic agricultural production due to adverse weather conditions and higher prices of agricultural products in the world market. Meanwhile, core inflation has remained close to the middle of the target range (2.4 percent in April). Since early 2003, Peru's currency has been broadly stable vis-à-vis the U.S. dollar—within ±1 percent of the mean. In real effective terms, the nuevo sol depreciated by close to 11 percent in 2003, following a 5½ percent depreciation in 2002.

Figure 2. Employment and Unemployment

(Employment index, October 1997 = 100)



1/ Series begins in 1998; quarterly through 2000; three-month moving average since 2001.

Figure 3. Inflation

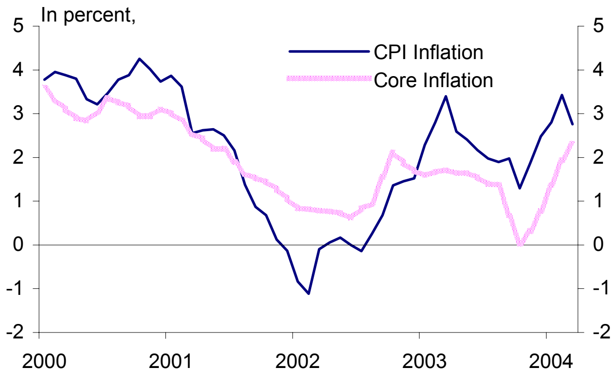
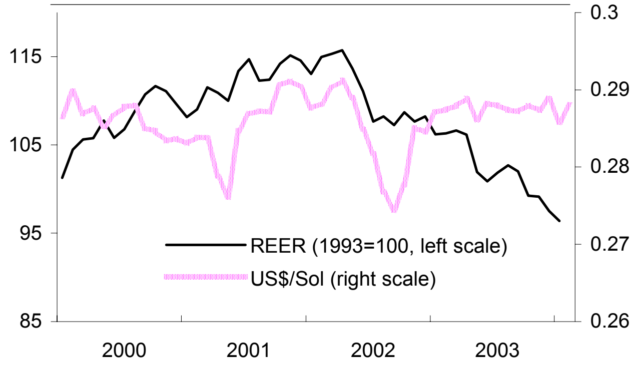


Figure 4. Exchange Rate 1/



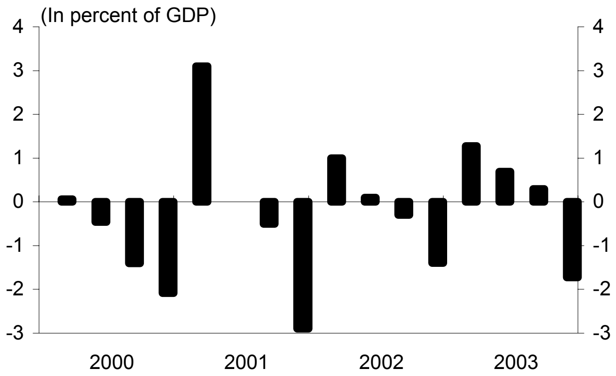
1/ Trade weighted index of nominal exchange rates deflated by seasonally adjusted relative consumer prices. An increase (decrease indicates appreciation (depreciation).

6. ***In 2003, fiscal consolidation was in line with the government's target.*** The deficit of the combined public sector was reduced from 2.2 percent of GDP in 2002 to 1.7 percent of GDP (Tables 2–5).[2] Revenue was boosted by tax measures introduced in late 2002 and mid–2003, including increases in the VAT and excise rates, a broadening of the VAT withholding schemes, a hike in the personal income tax rate, and the elimination of corporate income tax exemptions. Pressure on spending was strong, with increases in teacher wages

[2] This result takes into account a reclassification, in line with GFS 2001 methodology, of the amortization of CPI-indexed pension recognition bonds as a below-the-line item (instead of a current transfer), and of accrued interest payments as an expenditure item. Following this reclassification, the 2003 deficit was lowered by 0.2 percent of GDP (the 2002 deficit was left unchanged). For details on recognition bonds, see Country Report No. 04/156.

and domestic security outlays accommodated in part by cuts in high-income civil servant wages and nonsocial expenditures. In real terms, the primary spending of the general government grew by 3.6 percent, above the 3 percent limit set in the Fiscal Responsibility and Transparency Law (FRTL), which congress waived on an exceptional basis.

Figure 5. Combined Public Sector Primary Balance

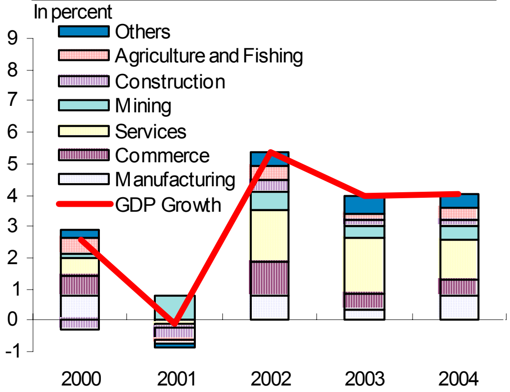


7. ***The special powers granted by congress to the Executive in September 2003 to issue a broad tax reform lapsed in February, with only modest achievements.*** The measures that were implemented included:

Box 1. Peru: Growth Performance

During 2000–2003, real GDP growth was broad-based. The services sector, mostly associated with transport and communications, government services, and restaurants and hotels, accounted for just over 30 percent of total growth. Moreover, commerce, manufacturing, and mining each represented 15 percent of total growth.

Contributions to growth by year



In 2004, growth is expected to continue to be broad-based, with services and manufacturing accounting for 50 percent of the total.

Constraints to Growth

The following constraints to increased employment and sustained and high growth are being addressed:

- ***Inadequate infrastructure.*** The poor quality of roads and ports results in high transportation costs and hamper market access.
- ***High labor costs.*** These costs, primarily associated with high payroll taxes and severance payments, constitute an important barrier to promoting formal employment in large firms, which currently employ about 20 percent of the economically active population.
- ***An inefficient judiciary system.*** This hampers the enforcement of contracts and a prompt resolution of commercial disputes, weakening the investment climate.
- ***Low financial intermediation.*** Efficiency could be affected by the recent introduction of the financial transaction tax (FTT). Cost of credit for medium-and small-size firms remains high.
- ***Below-potential agricultural production.*** This reflects inadequate infrastructure, a weak legal framework for water use, and lack of well-defined property rights in rural areas.

Downside Risks to Growth

Peru's medium term vulnerability derives from external and domestic risks. External shocks could stem from a sharp decline in prices of primary exports and stronger competition in global textile trade, while domestic risks are related to political uncertainty in the run up to the 2006 elections.

(i) an increase in the rate and a broadening of the base of the income tax; (ii) a reduction in selected tariffs; (iii) an extension of the coverage of the VAT withholding schemes; and (iv) the strengthening of tax auditing and enforcement mechanisms. The authorities also introduced a temporary tax on financial transactions (FTT) levied on a broad base of credit and debits through 2006.[3] Tax efficiency remains hampered by the large size of the informal sector and the presence of substantial sectoral and regional tax exemptions.

8. ***Peru's external position strengthened in 2003 and financial indicators have continued to improve.*** The external current account deficit fell from over 2 percent of GDP in 2002 to 1¾ percent, driven by commodity export growth (Box 2). Private capital inflows remained strong, particularly foreign direct investment in the natural resource sector (Tables 6 and 7). Gross international reserves rose by US$½ billion during 2003 and by a further US$¼ billion during the first four months of 2004, to US$10½ billion at end-April 2004. The net foreign exchange position of the central bank, which excludes reserve requirements on foreign currency deposits and public sector deposits, is comfortable, at US$5 billion. Total external debt (including private debt) remained broadly stable during 2003, at the equivalent of 49 percent of GDP. The Lima stock exchange index surged by 75 percent, reflecting higher mineral product prices, and Peru's sovereign spread continues to be among the lowest in the region—even though it rose to 400 basis points at end-April in the context of a decline in commodity prices and concerns about interest rate increases in mature markets.

Figure 6. Gross International Reserves

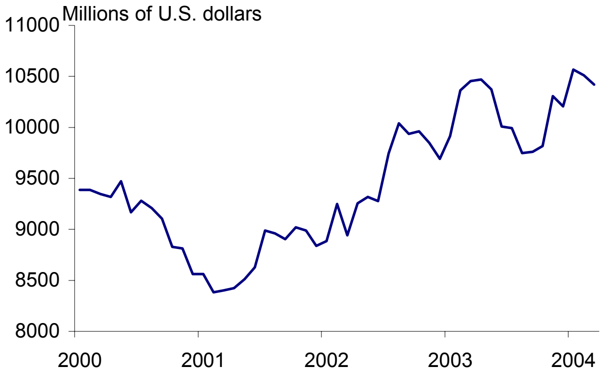
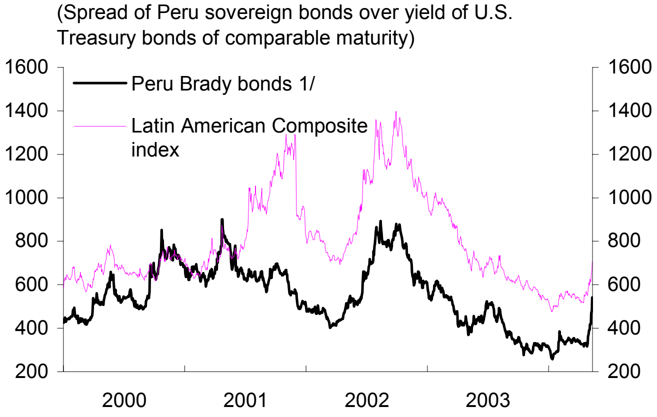


Figure 7. Country Risk



1/ Peruvian Brady bonds were first issued on March 31, 1997.

9. ***Monetary and exchange rate policies are being conducted within an inflation targeting framework*** (Box 3). The authorities have continued to use the interbank interest rate as their intermediate target, which has remained within the reference rates set by the central bank at the beginning of each month.[4] At the same time, the central bank has been sterilizing

[3] The rate of the FTT was initially set at 0.15 percent but, in late March 2004, congress lowered this rate to 0.10 percent and reduced the coverage of the tax.

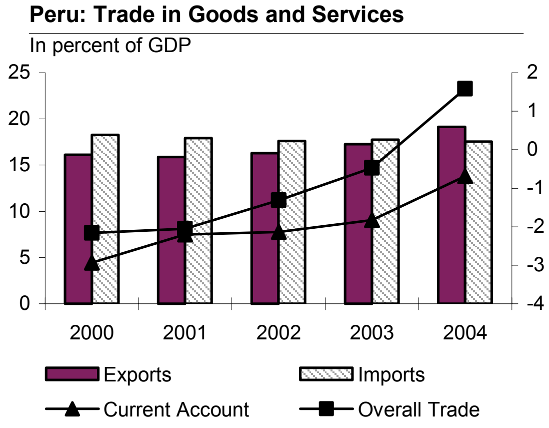
[4] At end-March 2004, the levels of the two reference rates were 3.25 percent for the rate on direct Repo operations and short-term credit for monetary control and 1.75 percent for the rate on overnight deposits.

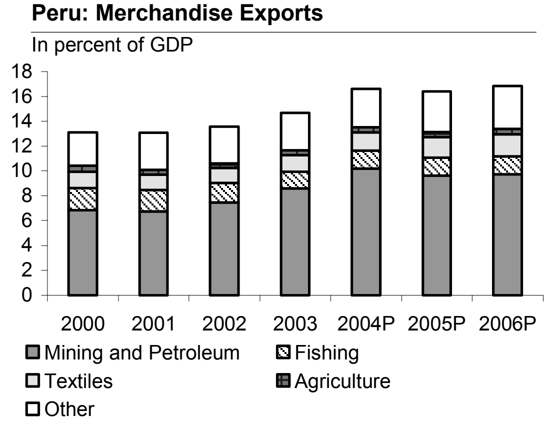
Box 2. Peru: Trade Developments

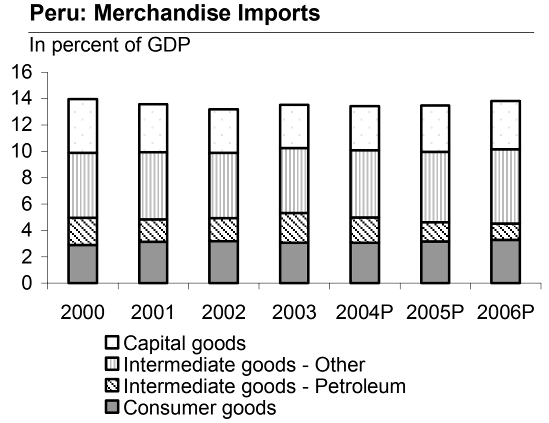
Peru's trade balance has improved substantially in recent years, driven by favorable prices and expanded production in the mineral sector. Prices for Peru's exports rose by 8 percent in 2003, with a further 13 percent increase expected in 2004, driven by gold, copper, and other mineral exports. In 2004, the trade balance is expected to shift to a surplus, supporting an improvement in the current account deficit to below 1 percent of GDP, from about 7 percent a decade ago.

Efforts to further liberalize trade and address structural factors that hamper competitiveness in tradable sectors will be important to increase and diversify Peru's exports. While Peru has a relatively open trading regime, trade in goods and services have averaged about 35 percent of GDP in recent years, compared with 50 percent for all developing countries. Over half of Peru's exports are concentrated in mining products. A possible free trade agreement with the United States would be important for export diversification as the United States represents Peru's largest trading partner and a key market for dynamic non-traditional sectors such as textiles and specialty agricultural products under existing, temporary preferential access arrangements. At the same time, improvements in road and port infrastructure, reduction in regulatory and legal uncertainties for investors, more flexible labor markets, and strengthened conditions for technology transfer and effective R&D will be essential to increasing and diversifying exports.

In the near term, expanded mining volumes and continued growth in non-traditional sectors are projected to compensate for stabilization of mineral prices in supporting export growth. A number of new mining projects are expected to come on line in the next few years. At the same time, textile exports are projected to continue to grow 15–20 percent annually in coming years, driven by exports to the U.S. market. However, there are downside risks, related to recent declines in commodity prices, the lapse of the Multifiber Arrangement and the need to address capacity constraints.







Mining investments and a second stage of the Camisea natural gas project are expected to drive import growth in coming years. The coming on line of the first stage of Camisea later this year will lead to a moderation of fuel imports. Investment in Camisea II is expected to total roughly 3 percent of GDP through 2007. The volume of petroleum imports is projected to decline by about 15 percent by 2006 from recent average volumes, partly as a result of Camisea I.

Box 3. Peru: Monetary and Exchange Rate Policies

Monetary Framework

Background. The Central Bank of Peru (BCRP) operates under an inflation targeting (IT) framework. The BCRP sets an annual inflation target of 2.5 percent, with a range of variation of ± 1 percentage point around the target point. The Board of the BCRP announces annual/monthly monetary programs at the beginning of each year/month, respectively, in terms of the interest rates used by the BCRP in some of its operations with the banking system. These rates set a reference band for the interbank rate, and the BCRP's operations are directed to keep this rate within the reference band.

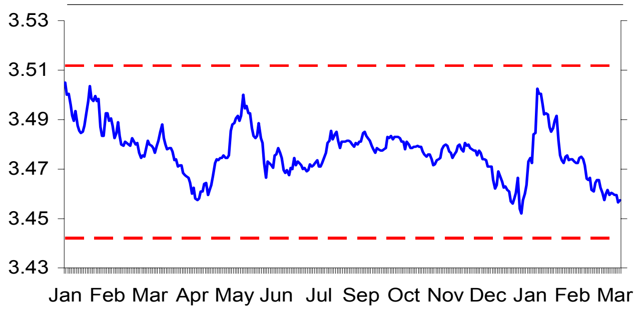
Monetary Policy during 2003. In the first half of 2003, inflation dynamics mostly reflected supply shocks. As these factors subsided, annual inflation rates situated in the lower part of the band, allowing for an expansionary policy stance—reference rates were reduced four-times (25 bps in July, September, and November, and 50 bps in August). The BCRP's actions led to falls in the interbank rate, which declined from 3.8 percent in December 2002 to 2.5 percent in December 2003, and was associated with a general reduction in the interest rates in soles.

Exchange Rate Regime

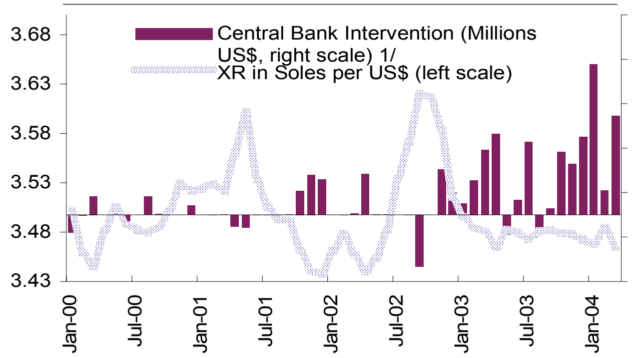
Background. The Peruvian authorities have indicated that the exchange rate is an instrument for achieving the paramount goal of monetary policy: the control of inflation. In this regard, interventions in the forex market are sterilized to avoid any conflict with monetary policy.

Exchange Rate Policy during 2003. BCRP interventions in the foreign exchange market have helped stabilize the exchange rate against the U.S. dollar (it has remained within ±1 percent of the mean). This performance contrasts with the more volatile behavior of the nuevo sol up to the beginning of 2003 and with the tendency toward appreciation shown by most other currencies in the region against the U.S. dollar since the end of 2002. The central bank views such intervention as an "opportunistic" policy of reserve accumulation warranted by the potential external shocks and the political uncertainties in the run up to the 2006 elections.

Peruvian Nuevos Soles per U.S. Dollar, 2003-2004



Exchange Rate and Central Bank Intervention, 2001 - 2004



1/ Positive means dollars purchased

its foreign exchange purchases through issuance of its own certificates of deposits in domestic currency (at end-April 2004, the stock of these CDs was equivalent to US$1.7 billion, or 3 percent of GDP). However, the 12–month rate of base money growth has picked up significantly in recent months (18 percent at end-April), reflecting in part a higher preference for cash associated with the introduction of the tax on financial transactions (Table 8). In March 2004, the central bank introduced some flexibility in the computation of the reserve requirements and broadened their coverage to include foreign lines of credit, with a view to further protecting the financial system from sudden reversals in international capital flows.

10. ***Progress has been made in recent months in the structural reform area.*** In particular, the authorities granted in concession a hydro-electrical project (Yuncan) and sold minority shareholdings in an oil refinery (Relapasa). In February 2004, the government enacted legislation to reinforce the soundness of the decentralization framework. In the banking area, supervision of ongoing bank restructuring programs is being enhanced and legislation was recently approved to implement credit exposure limits and strengthen the definition and measurement of capital, in line with FSAP recommendations. The Superintendency of Banks (SBS) has recently introduced norms on provisioning and loan classification that take into account borrowers' currency mismatches and promote the use of Value at Risk (VaR) models for the measurement of exchange rate risks.

11. ***The domestic political situation remains difficult.*** The approval ratings of most political leaders, including President Toledo, continue to be low, and social and political tensions have increased in recent months. The congressional representatives of the governing coalition parties at times lack voting discipline, which jeopardizes congress' support for the measures sponsored by the government. The new cabinet appointed in February 2004, composed mostly of qualified professionals, has elaborated a policy road map (*Hoja de Ruta*) for the next two years, in close consultation with civil society. Under this road map, macroeconomic policies are to be strengthened further while the pace of structural reform in key areas is to be accelerated.

III. Policy Discussions And The Program For 2004–06

12. ***The objectives of the program for 2004–06 are to maintain macroeconomic stability and strengthen confidence, foster robust growth and employment, and further reduce vulnerabilities*** (Table 9). The program aims at enhancing the basis for strong economic growth—averaging 4½ percent a year during 2004–06. It focuses on the continued implementation of the inflation-targeting framework and on fiscal consolidation, with a view to lowering the debt-to-GDP ratio from 47½ percent in 2003 to 41 percent in 2006. The overall deficit of the combined public sector is to be reduced from 1.7 percent of GDP in 2003 to 1 percent a year in 2005–06. Over this period, about one third of the adjustment effort of the central government is to be achieved through higher revenue, and the remainder through a containment in current expenditure growth, reflecting in part the sustained pursuit of prudent wage policies. Although there are downside risks to the program, associated primarily with the difficult political situation, potential benefits can be expected from a possible free trade agreement with the United States and the development of a new large gas export project (Camisea II).

Macroeconomic Framework

	2002	Prel 2003	Projected 2004	2005	2006
Real GDP growth (in percent)	4.9	4.0	4.0	4.5	4.5
Private sector investment (in percent of GDP)	15.6	15.7	15.4	15.8	16.0
End-of-period inflation (in percent)	1.5	2.5	2.5	2.5	2.5
External current account deficit (in percent of GDP)	2.1	1.8	0.7	0.8	0.7
Overall fiscal deficit (in percent of GDP)	2.2	1.7	1.4	1.0	1.0
Primary fiscal balance (in percent of GDP)	0.0	0.4	0.8	1.4	1.5
NIR accumulation (in millions of US$)	985	596	100	100	100
Gross official reserve coverage of:					
U.S. dollar deposits in the banking system	99.8	107.9	107.3	106.6	106.0
Short-term external debt	216.3	221.8	225.5	223.8	207.8
Public sector debt-to-GDP (in percent)	47.1	47.6	44.7	43.0	41.1

13. ***The program for 2004 envisages prudent macroeconomic policies and the implementation of a comprehensive package of structural reforms.*** Real GDP is projected to grow by 4 percent in 2004, and year-end inflation is targeted at 2½ percent, consistent with the recent transitory increase in food prices. Helped by favorable terms of trade, the external current account deficit is forecast to decline below 1 percent of GDP, and official international reserves are projected to rise further. The authorities' program also includes measures to foster private investment, modify a preferential public pension regime (*Cédula Viva*), lower non-wage labor costs, strengthen the legal framework for decentralization, and further reduce risks from dollarization.

A. Fiscal Policy

14. ***Under the 2004 program, the overall deficit of the combined public sector is to be reduced from 1.7 percent of GDP in 2003 to 1.4 percent.***[5] This reduction, consistent with Peru's Fiscal Responsibility and Transparency Law (FRTL), represents an important step toward reinforcing robust debt dynamics.[6] Fiscal consolidation is to be achieved mainly through restraint in the growth of primary expenditure. Despite the projected reduction in selected excises and tariff rates, central government tax revenue is forecast to rise by 0.3 percentage points of GDP. This increase would reflect higher corporate income tax collections associated with buoyant mineral export prices, the introduction of the tax on

[5] Under the previous accounting convention, the deficits would have amounted to 1.9 percent of GDP in 2003 and 1.6 percent in 2004 (see footnote 2).

[6] The main features of the FRTL are as follows: (i) establishment of a ceiling equivalent to 1 percent of GDP on the overall deficit of the combined public sector by 2005 (with deficits of 2 percent and 1.5 percent of GDP, respectively, for the transition years of 2003 and 2004); (ii) an annual limit of 3 percent on real expenditure growth of the general government; and (iii) quarterly adjustments to fiscal policy, to ensure compliance with the deficit ceiling. In the case of exceptional circumstances, the overall deficit would be allowed to gradually rise to 2 percent of GDP over a three-year period.

financial transactions (FTT), and the full-year effect of the excise and VAT rate increases introduced in July 2003 (Box 4).[7]

Box 4. Peru: Tax Measures Introduced in Late 2003 and 2004

The tax measures introduced in late 2003 and to be adopted in 2004 include the financial transaction tax (FTT), a rate increase and broadening of the base of the income tax, and tariff reductions. The FTT, which has just been lowered to 0.10 percent, is expected to yield 0.3 percent of GDP in 2004. The corporate income tax rate has been raised to the maximum marginal rate for individuals (from 27 to 30 percent), the carry forward of losses has been limited to four years or 50 percent of the losses, loss provisions for banks have been tightened, and the exemption for capital gains of real estate has been removed. Import tariffs for over 1,000 items were reduced at end-December, while a tax credit on the excise on fuel for transportation of passengers is expected to be adopted shortly.

Tax administration measures are being taken to fight tax evasion. Although no comprehensive estimate of tax evasion is available in Peru, VAT and personal income tax evasion is estimated at 6-7 percent of GDP.[1] The authorities are improving tax administration by extending the coverage of the VAT withholding schemes to imports and large taxpayers and strengthening supervision and enforcement:

- Since November 2003, the custom administration agency has been withholding 3.5 percent of the sale price of imports (10 percent for unregistered and occasional importers).
- For large purchases (above US$200), the coverage of the 6 percent withholding tax to suppliers was extended to a larger number of sectors in late 2003.
- A withholding tax equivalent to one percent of sales, currently applied by large fuel sellers in their transactions with fuel retailers, will be extended to other sectors in July 2004.
- Other measures include improving the simplified regime for small taxpayers, strengthening taxpayer registration systems, expediting VAT refunds, requiring public entities to ensure that their suppliers comply with their tax obligations, tightening the supervision of NGOs, and introducing an electronic system to assist the national tax agency in the confiscation of assets.

[1] For details, see: Castro, Schenone, and Trujillo (2002), "*Temas Selectos de Política y Administración Tributaria*", IMF; and Kopits, Ley, and Haindl (2003), "*Comentario sobre la Propuesta de Reforma Tributaria*", IMF.

15. ***The growth of the primary spending of the general government is projected to remain below 3 percent in real terms.*** The authorities are committed to keep a tight lid on expenditure while protecting social expenditure and making room for improvements in infrastructure. Staff urged the authorities to minimize increases in recurrent expenditures during 2004, as large increases could potentially jeopardize the feasibility of achieving the overall fiscal targets for 2005–06. The authorities noted that about 0.2 percent of GDP of the current outlays undertaken in 2004 are of a temporary nature and would not be repeated in 2005—including the purchase of military equipment, capitalization of *Banco Agrario*, and some infrastructure projects—which would help comply with the program fiscal objectives for 2005–06.

[7] The authorities do not intend to reverse the VAT increase implemented in 2003.

16. ***The distortionary effects of the FTT have been significantly reduced.*** In late March, congress passed legislation lowering the FTT rate from 0.15 percent to 0.10 percent with immediate effect, and reducing it further over the next two years (to 0.08 percent at end–2004 and 0.06 percent at end–2005). The new legislation also narrowed the FTT base and limited exemptions (Box 5). Enabling legislation related to the implementation of the FTT is expected to help strengthen tax administration and discourage tax avoidance through cross-checking of information on income tax returns and financial transactions. Administrative controls are to be enhanced by requiring that corporate purchases above a certain level take place through the banking system in order to be deductible under the corporate income tax or eligible for VAT reimbursement. The FTT is to be eliminated by end–2006.

17. ***The authorities are at an early stage in exploring the scope for innovative financial mechanisms that they intend to develop to support increased public investment in a non-inflationary manner.*** The authorities agreed with staff that any actual or contingent liabilities assumed by the government under such mechanisms would need to be recorded transparently in the budget and be fully consistent with their objectives for fiscal consolidation and sustainable debt dynamics.

18. ***To ensure medium-term fiscal sustainability, the authorities are committed to continue pursuing a sound public debt management***. Three-quarters of the gross financing requirements for 2004 are expected to be covered by official creditors and already completed sovereign debt placements abroad. The remaining will be raised in the local bond market (US$550 million) and through privatization (US$110 million). The authorities also intend to manage rollover risks and re-profile external debt, through swaps and other market operations, as market conditions permit. To facilitate a gradual shift in debt composition toward medium- and long-term domestic currency instruments, the program includes an overall debt ceiling, instead of the past practice of separate ceilings for domestic and foreign debt. The authorities intend to continue including collective action clauses (CACs) in foreign sovereign debt placements. The debt sustainability analysis shows that both external and public sector debt-to-GDP ratios are relatively robust to alternative assumptions about underlying macroeconomic variables (Box 6).

B. Monetary, Exchange Rate, and Financial Sector Policies

19. ***Monetary policy will continue to be managed prudently within the inflation-targeting framework.*** Inflation is expected to remain at or slightly above the upper end of the inflation target band (3.5 percent) for a few months, prior to converging to the mid-range of the inflation target band (2.5 percent) by year-end. The authorities considered that the recent increase in base money was temporary, but indicated their readiness to tighten monetary policy, if necessary, to attain the inflation target of the program.

20. ***The central bank reaffirmed its commitment to a floating exchange rate regime while defending its policy of intervention in the foreign exchange market.*** The authorities considered that central bank intervention was temporary and designed to take advantage of sustained foreign exchange inflows to accumulate foreign reserves beyond the program objectives. They stressed that the reserve accumulation was warranted by potential external shocks and political uncertainties in the run up to the 2006 elections, but emphasized that achieving the inflation target would always take precedence over the reserve accumulation goal. The authorities also remarked that the costs associated with the increase in the stock of

central bank CDs resulting from the sterilization of intervention remained low, and that the central bank was not expected to generate quasi-fiscal losses in 2004. While agreeing that further bolstering official reserves may be appropriate to mitigate vulnerabilities, the staff encouraged the authorities to let the exchange rate move more freely, noting that a higher degree of flexibility would enable economic agents to adjust better to shocks.

Box 5. Peru: The Financial Transaction Tax (FTT) in a Regional Perspective

The FTT currently in place in Peru has a rate of 0.10 percent and applies to both bank credit and debit operations. In Latin America, statutory rates range between 0.1 percent in Peru and 0.6 percent in Argentina. In Peru, the FTT is imposed upon debit and credit operations on checking, saving, investment, and term accounts, including in some cases overdraft facilities in current accounts, transactions in spot and futures markets and credit card transactions. In Peru (as in Argentina and Bolivia), the FTT is also imposed on financial institution credit and loan disbursements.

Financial Transactions Tax in Latin America

	Statutory rate (in percent)	Base	Productivity 1/	Complementary Regulation
Argentina	0.60	Debits and Credits	1.30	Maximum two check endorsements and cash payment below US$1,000. A 10 percent credit against the income tax.
Brazil	0.38	Debits	4.18	Maximum one check endorsement.
Bolivia	0.30	Debits and Credits	n.a.	
Colombia	0.40	Debits	2.00	
Venezuela	1.00	Debits	1.55	Second and subsequent endorsement are taxed.
Peru	0.10	Debits and Credits	2.00	Obligation of using bank accounts for transactions above US$1,900 and tax deductions.

Sources: "The Rates and Revenues of Bank Transactions Taxes", by Baca-Campodonico, de Mello, and Kirilenko.

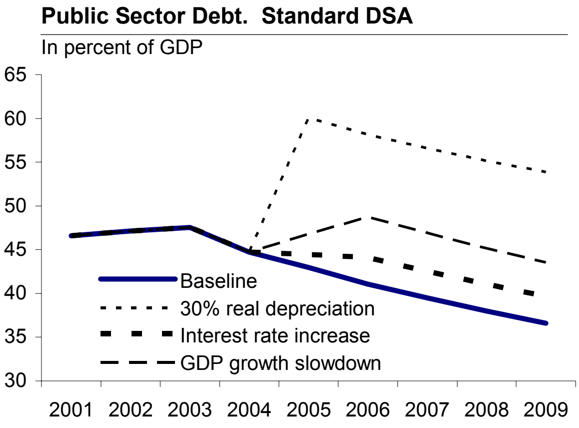
1/ Measured by the ratio of revenues as a percent of GDP to the average effective rate. Estimates for Peru and Bolivia.

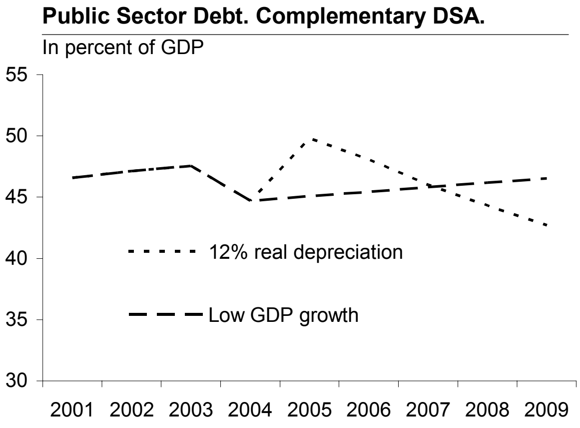
The FTT was adopted to boost revenue, both directly and through helping reduce general tax evasion. In contrast with most other Latin American countries, the FTT was not introduced to respond to an emergency situation. In Argentina and Bolivia, it was introduced in response to a sharp decline in tax revenue in a context of depressed economic activity and increased tax evasion. In Colombia, it was adopted to fund the resolution of a banking crisis. In Venezuela, the FTT has been adopted on several occasions in response to severe drops in oil revenue. In Brazil, it was introduced in 1994 and 1997 to implement an emergency fiscal adjustment by increasing federal tax revenues not shared with the states.

Most of the exemptions of the FTT in Peru are in line with other Latin American countries. Most countries, including Peru, provide exemptions for interbank and capital markets transactions and withdrawals from pension and unemployment-insurance plans. Some countries have also exempted export credits, the acquisition and redemption of shares of mutual funds (Argentina), and withdrawals from certain savings accounts (Bolivia, Colombia, and Peru). Most countries, including Peru, have provided exemptions for government agencies, NGOs, educational and religious institutions, and diplomatic representations. In all countries except Bolivia, transfers between the accounts of a same depositor are exempt. These transactions account for a high percentage of total financial transactions in Peru because of the degree of dollarization. In Peru, the FTT does not apply to bank deposits from the payment of wages and salaries.

Box 6. Peru: External and Public Debt Sustainability Analysis

Standard debt sustainability analysis (DSA) shows that both external and public sector debt-to-GDP ratios are relatively robust to alternative assumptions about underlying macroeconomic variables. Baseline projections show declining debt-to-GDP ratios. Temporary adverse shocks to interest rates[1] and real GDP growth lead to small increases in these ratios, which gradually return to a declining path once normal conditions are restored. Given the high proportion of debt denominated in dollars, a sustained 30 percent real depreciation, would lead to a sharper initial increase in the debt-to-GDP ratios, with a more protracted period of higher ratios than the observed in the other scenarios.





A complementary DSA exercise (Appendix I) shows that external and public debt is resilient to real exchange rate shocks of magnitudes experienced by Peru in the recent past, but that the debt dynamics appear somewhat vulnerable to a sustained reduction in demand for Peru's exports. A 12 percent permanent real depreciation that leads to a contraction in domestic demand and an improvement in the external current account would initially result in somewhat higher external and public debt-to-GDP ratios, but thereafter those ratios would decline. However, a reduction in growth from 4 percent to 2 percent, owing to an export shock, countered by an increase in the fiscal deficit from 1 percent of GDP to 2 percent, would lead to a moderate rise in external and public sector-debt-to-GDP ratios.

[1] The shock consists in setting the nominal interest rate at its historical average plus two standard deviations in 2005 and 2006. As a result, nominal interest rates increase by 260 basis points during those two years.

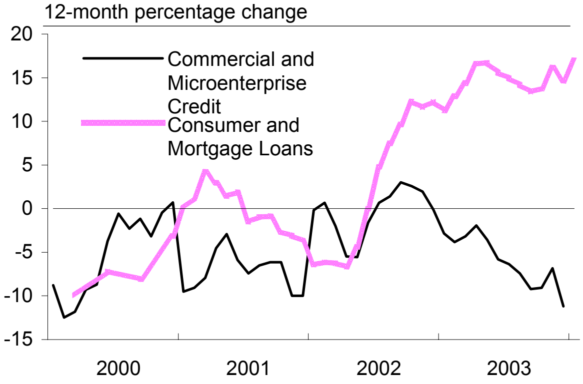
21. ***Further reducing financial dollarization and strengthening bank supervision are important policy goals.*** The authorities expect dollarization to continue to decline gradually, with the sustained implementation of sound economic policies, rigorous banking system oversight, and further deepening of domestic capital markets. Although bank supervision has continued to improve, a few issues remain. Accordingly, the Superintendency of Banks (SBS) is committed to develop a monitoring system aimed at measuring the currency risks of lending operations by end–2004. Moreover, the authorities have requested a follow-up FSAP to focus on implementation of the New Capital Accord, issues related to the regulation and supervision of insurance companies and private pension funds, corporate governance, and the effectiveness of CONASEV, the entity in charge of the supervision of capital markets. Staff encouraged the authorities to continue implementing ongoing bank strengthening programs and to keep

working with congress to ensure enactment of legislation aimed at improving the legal protection of bank supervisors.

22. ***The program aims at reducing borrowing costs for creditworthy small and medium-sized firms.*** As the domestic capital market has been expanding, commercial bank lending has been contracting while bank credit for housing, consumption, and small and medium-scale enterprises has been increasing. The authorities see this development as a natural consequence of the growth of the domestic capital market, which is increasingly providing large corporations long term financing at generally lower interest rates than those charged by banks. To further promote the development of lending to creditworthy small and medium-sized firms, the authorities are committed to strengthening the basis for collateralization, including through the centralization of registries and the establishment of specialized commercial courts. Under the program, sectoral support operations will continue to be managed prudently, including Banco de la Nación's net lending to the private sector. As in recent years, the Agricultural Bank will limit its lending operations to channeling credit lines from abroad to agricultural producers, and its quasi-fiscal operations with small-scale farmers will continue to be recorded in the budget.

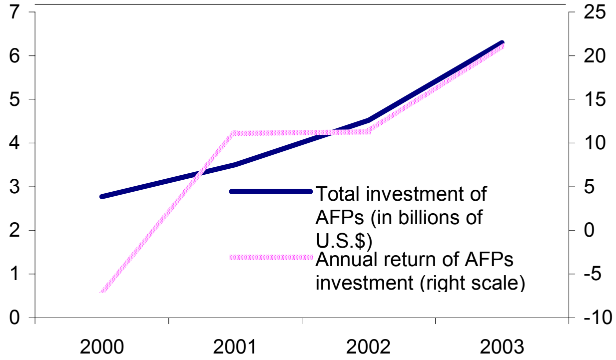
Figure 8. Credit to the Private Sector 1/

12-month percentage change



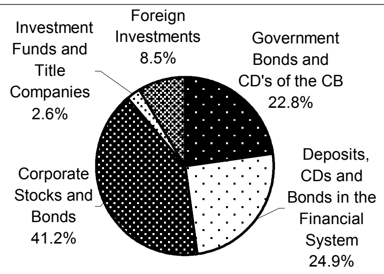
1/ U.S. dollar stocks are valued at market exchange rates.

Figure 9. Total investment of AFPs



23. ***The authorities are committed to allow private pension funds to invest a higher proportion of their assets abroad.*** At end-March 2004, total investments of these funds amounted to US$6.7 billion. In April, regulations were eased, allowing funds to invest up to 10.5 percent of their assets abroad (9 percent previously).[8] The authorities noted that their priority was to support the development of the local capital market, but agreed that further gradual increases in foreign investment limits would help diversify the risks of the funds. Increasing these limits in the current context

Figure 10. Portfolio composition of the AFPs (as of end-March 2004)



[8] This compares with 30 percent in Chile (raised recently from 25 percent) and Colombia. In Mexico, the limit is 10 percent, but, starting December 2004, pension funds will be able to invest up to 20 percent in non-Mexico corporate bonds, with a minimum "A-" rating in the global scale.

appears timely, given the improvement in the external current account balance and sizeable capital inflows.

C. Structural Reforms

24. ***The 2004–06 program includes growth-enhancing reforms aimed at fostering private investment and improving resource management in the public sector.*** Most of these reforms are being supported by the World Bank and the Inter-American Development Bank (IDB).

25. ***Steps are being taken to further foster an environment conducive to private sector-led growth and employment.*** With IDB assistance, the protection of property rights is being strengthened with the establishment of commercial courts to adjudicate commercial disputes and speed up contract enforcement, while improving the efficiency of non-judicial resolution mechanisms (arbitrators and mediators). In this context, special commercial courts with appropriate training for judges and personnel, efficient internal procedures, and technological and budgetary support will be established in Peru's major cities over the next years. The first of these courts will start functioning in Lima by end-September.

26. ***Private sector investment is to be boosted by operating concessions and Public-Private Partnership (PPP) operations in the areas of port and road construction and maintenance.*** The authorities fully shared staff's views on the need for a transparent fiscal accounting of PPP operations.[9] Under the program, this treatment will for the time being remain unchanged from the previous program, with all debt guarantees covered under the debt ceiling.[10] In 2004, the limit on the contracting and guaranteeing of public debt will be adjusted upwards by up to US$400 million (0.6 percent of GDP) to allow private borrowing under PPP operations related to large road construction projects; full use of this adjustor would remain consistent with a declining debt-to-GDP ratio.

27. ***The authorities intend to improve resource management in the public sector, with a view to creating more room for social and infrastructure spending.***

- ***Pension reform.*** The authorities have recently introduced to congress a constitutional amendment to reform the preferential pension plan for public workers (*Cédula Viva, CV*). The amendment—which has broad political support and requires two consecutive legislature sessions to be approved—is necessary for a reform aimed at centralizing the administration of the CV to improve its management and eliminate fraudulent payments. The reform also seeks to eliminate the automatic link between pensions and wage increases of civil servants which, on a full-year basis, would reduce central government expenditure by 0.2 percent of GDP.[11] In 2004, the authorities are also

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[9] Peru will be included in the Pilot Case Studies directed at new approaches for productive public investment in infrastructure in a manner consistent with maintaining macroeconomic stability and debt sustainability (see *Public Investment and Fiscal Policy*, March 2004.

[10] Under the present treatment, expenditure is recorded when it occurs, estimates of contingent costs are recorded in budget documentation, and any government guarantees for private sector debts is included in the stock of government debt.

[11] Current CV beneficiaries are eligible for pensions of up to about US$7,000 per month, compared with about US$170 in the general pension regime (GPR), despite the fact that retirees have contributed only 6 percent of their salaries (13 percent in the GPR). Treasury subsidies to the CV amount to 69 percent of total subsidies to

(continued)

committed to designing a reform plan for the pension regimes of the police and the military and will continue working with congress to stop legislative proposals that would allow a broad-based return of affiliates in the private pension system to the public system.

- ***Civil service.*** In the short run, the authorities plan to complete a census of government employees and pensioners, fully computerize the payroll, remove ghost employees, and continue improving procurement procedures. Draft legislation will be submitted to congress during 2004 to enable the implementation of the recently approved framework law on public sector personnel management. The authorities also plan to adopt a comprehensive reform of the public sector wage structure once the reform of the preferential pension regime of the *CV* has been completed and the link between public wages and pensions has been cut.

- ***Public enterprise pricing policies.*** The authorities plan to introduce by mid–2004 a system to ensure that prices of the state oil company are not artificially kept below world oil prices.

- ***Tax exemptions.*** Staff stressed the importance of further efforts to increase revenue generation to ensure that resources are available to meet critical social needs and support strengthened public investment. In their effort to phase out gradually sectoral and regional tax exemptions, the authorities will keep working with congress toward early passage of legislation phasing out exemptions in at least two regions.

28. ***The program envisages a reduction in labor costs.*** High regulatory labor costs prevent job creation and promote informality in the economy (total regulatory costs amount to close to 60 percent of wages). As a first step towards reducing labor costs, legislation will be submitted to congress by September 2004 to eliminate the special payroll tax (IES) by year-end. Staff encouraged the authorities to enhance training to increase labor productivity and to resist pressures to increase severance payments. Staff also welcomed plans to reinstate the unemployment protection system that existed until 2001.[12] The mission also encouraged the authorities to avoid further increases in the minimum wage during 2004 (it was last raised by 12 percent in September 2003).

29. ***The authorities intend to proceed with fiscal decentralization in a cautious and fiscally-sound manner.*** During 2004, they plan to enact legislation to clarify the functional responsibilities among the central, regional, and local governments, and to establish requirements for the certification of subnational governments' administrative capacity to deliver public services effectively. The World Bank has actively supported the development of a sound decentralization framework, including the design and implementation of decentralization of the social sectors and pro-poor spending policies.

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public pension plans, while CV affiliates only account for 20 percent of all pensioners. For more details, see Country Report No. 04/156.

[12] Under this system, firms deposited one-half a salary every six months in an earmarked account. Workers could withdraw up to 50 percent of accumulated contributions at any point in time—and the balance only upon leaving their job for voluntary reasons or when laid off.

30. ***Peru's integration in the global economy will be further strengthened.*** The authorities remain committed to further trade liberalization through both bilateral and multilateral negotiations. Discussions for a free-trade agreement with the United States started on May 18, 2004. Such an agreement could promote the growth of labor-intensive export industries, and make Peru's current favorable access to U.S. markets for nontraditional products permanent, while helping consolidate pending structural reforms. The authorities also indicated that some progress had been made in the negotiation of a free trade agreement with Thailand.

D. Other Issues

31. ***Fiscal Transparency and Data ROSCs.*** While economic statistics are adequate for policy formulation, surveillance and program monitoring, the authorities remain firmly committed to implementing the main recommendations of the ROSCs.[13] They have published the fiscal and data ROSCs and are working toward implementing many of the recommendations, although those requiring congressional approval could take some time.

32. ***Safeguards assessment.*** An off-site safeguards assessment of the Central Reserve Bank of Peru (BCRP) was completed on July 26, 2001, and its recommendations have been implemented. Under the proposed stand-by arrangement, the BCRP is subject to another safeguards assessment, which has been initiated.

IV. Program Modalities And Risks

33. ***The proposed SBA, with low access and precautionary in nature, covers the period through mid-August 2006.*** Total access under the arrangement would be equivalent to SDR 287.3 million (45 percent of quota, or about 20 percent on an annual basis), and is to be phased in 10 purchases, including an initial tranche of SDR 80 million available upon program approval (Table 11). The authorities do not intend to draw under the arrangement. Peru's current outstanding use of Fund resources is SDR 80.3 million (12.6 percent of quota).

34. ***The program envisages five reviews, beginning at end-October 2004.*** The first review will concentrate on the fiscal outlook, implementation of the inflation targeting framework, reform of the *Cédula Viva*, concessions and PPP monitoring, banking system supervision and regulation, and reforms to improve competitiveness, institutions and the investment climate. The program includes quantitative performance criteria, an inflation consultation mechanism, structural performance criteria, and structural benchmarks (Table 1 of the LOI and Table 1 of the MEFP).

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[13] The fiscal ROSC recommendations included introducing transparent regulations for the civil service; establishing a stable legal framework for the budget, treasury operations, and debt management (partially implemented); publishing regular reports on quasi-fiscal operations, contingent liabilities, and fiscal sustainability, and widening the coverage of the Financial Management Information System (implemented). The data ROSC recommended to strengthen technological and manpower capacity, disseminate terms and conditions for published data, reduce wage and earnings data lags, and replace the wholesale price index with a producer price index. For details, see Country Report No. 04/155.

35. ***There is minimal risk of a failure to repay the Fund, even if Peru were to draw the full amount available under the program.*** Fund credit outstanding would peak in 2006 at 43½ percent of quota, representing 0.6 percent of GDP and 4.0 percent of gross foreign reserves (Table 12).

36. ***Political uncertainty remains the key risk to program implementation.*** Despite sharp political divisions, over the past two years the authorities have been able to move forward their economic agenda. Nonetheless, social and political tensions have increased in recent months and as the presidential elections draw closer, the government is likely to face strong expenditure pressures that could jeopardize fiscal discipline, while implementation of key structural reforms could become more challenging. Potential changes in global market conditions are also relevant, particularly in the context of Peru's high level of financial dollarization, the relatively high level of public debt, and the strong sensitivity of the trade balance to commodity price developments. These risks, however, are mitigated by the strong reserve position and continued progress in fiscal consolidation.

V. Staff Appraisal

37. ***In recent years, the Peruvian authorities have made commendable efforts toward maintaining macroeconomic stability, restoring output growth, and reducing vulnerabilities.*** Notwithstanding a difficult political environment, solid progress toward reducing the fiscal deficit and a prudent monetary framework have helped attain price stability. Progress on structural reforms has been good in a number of areas. The financial sector has been strengthened, a sound legal framework for decentralization created, and an improved budgetary management is in place. In contrast, recent tax reforms have been slow with revenues remaining comparatively low, and progress has been limited in the area of concessions. Unemployment and poverty rates remain stubbornly high.

38. ***Important obstacles to faster output and employment growth need to be addressed with determination.*** The economy remains vulnerable to exogenous shocks, and political cooperation and consensus building are likely to improve only gradually. In this context, the most pressing challenges are to consolidate macroeconomic stability and strengthen confidence, undertake structural reforms that deliver high sustainable growth and employment creation, and reduce vulnerabilities. The authorities' proposed program for 2004–06 is designed to address these challenges.

39. ***Peru's high external and public debt ratios underscore the need for continued fiscal consolidation.*** To put these ratios on a clear downward path, the program envisages a reduction of the public sector deficit to 1 percent of GDP or less by 2005–06, while protecting spending on critical social services and infrastructure projects. To this end, the authorities have adopted several revenue-enhancing tax measures and intend to keep the increase in primary spending below that of nominal GDP, while ensuring that capital spending meets critical infrastructure needs. The staff agrees with these objectives, but stresses the need for strengthened efforts aimed at curtailing tax exemptions, further widening the tax base, and improving expenditure efficiency in order to ensure that resources are available to meet critical social needs and support strengthened public investment. The staff also supports the authorities commitment to ensure that any new financing mechanism to support public investment is

accounted for transparently and is fully consistent with their fiscal consolidation and debt sustainability objectives.

40. ***The structural fiscal reforms envisaged in the authorities' program are critical for medium-term fiscal consolidation.*** In 2004, the authorities are taking welcomed actions—including the recent lowering of the FTT rate and their commitment to submit to congress draft legislation eliminating the payroll tax—to improve tax efficiency. They are also taking appropriate steps to reform the costly preferential public pension regime, and are committed to completing the legal framework for a sound decentralization process designed to promote effective provision of essential public services and safeguard the public finances. To bolster infrastructure investment, the authorities will grant private concessions and enter into public-private partnerships in a fiscally prudent and transparent manner. The program also includes steps to rationalize public sector salary and employment policies.

41. ***Public debt management will be focused appropriately on reducing currency and rollover risks.*** The authorities intend to gradually increase the share of public debt denominated in local currency and to undertake transactions that improve the profile of external public debt when market conditions permit. They will also continue to include CACs in sovereign debt placements.

42. ***The authorities' monetary and exchange rate policy framework is appropriate for achieving the program's inflation target.*** Nonetheless, the authorities should stand ready to tighten monetary policy, if inflationary developments in coming months were to suggest that the inflation target is not within reach. The staff supports the authorities' intention to maintain a solid cushion of foreign reserves, particularly in the period up to the 2006 elections. Care should be taken to ensure at all times that central bank intervention in the foreign exchange market is consistent with flexibility in the exchange rate regime and keeping the exchange rate in line with economic fundamentals.

43. ***The program includes efforts at strengthening and modernizing the regulation and supervision of financial intermediaries.*** Particularly important are actions to mitigate intermediaries' operational and dollarization risks. Staff welcomes the authorities' recent decision to raise the limits on private pension funds' investments abroad, and encourages them to proceed decisively in gradually relaxing these limits further. The staff fully supports the authorities' request for a follow-up FSAP and their continued efforts to implement ongoing bank strengthening programs.

44. ***The authorities' commitment to open trade is commendable.*** The staff encourages them to continue their participation in multilateral trade discussions and their efforts to establish free-trade arrangements with the United States and other trading partners. Such arrangements are expected to help bolster private investment and promote employment creation, both by promoting institutional strengthening in key areas and by reducing investor uncertainty associated with the temporary nature of existing preferential trade arrangements.

45. ***The staff also welcomes the authorities' reforms aimed at strengthening the investment climate.*** The establishment of an efficient commercial court system in Lima in 2004, as well as other actions to improve the functioning of collateral registries and to promote the development of the capital market will be important in this regard.

46. ***The authorities' proposed program for 2004–06 embodies a coherent set of policies to consolidate macroeconomic stability, fortify confidence, achieve sustainable growth, reinforce employment creation, and reduce vulnerabilities.*** Successful implementation of the program will reinforce confidence in continuity of prudent policies, strengthen the basis for overcoming many obstacles to broad-based and sustainable growth and employment generation, and for defining Peru's exit strategy from Fund-supported programs. Risks to the program include adverse term-of-trade shocks and policy slippages associated with possible political instability. However, the policy implementation momentum exhibited in recent years—including the authorities' determination to improve the quality of recent measures to bolster tax revenue—and the existence of political consensus in favor of critical reforms in certain key areas, mitigate concerns over such risks. On this basis, the staff supports the authorities' request for a new Stand-By Arrangement.

Table 1. Peru: Selected Economic Indicators

	2000	2001	2002	Prel. 2003	Programmed 2004	2005	2006
			(Annual percentage change)				
Production, prices, and trade							
Real GDP	2.8	0.3	4.9	4.0	4.0	4.5	4.5
Real domestic demand	2.4	-0.5	4.1	3.7	3.5	4.5	4.3
Consumer prices							
End of period	3.7	-0.1	1.5	2.5	2.5	2.5	2.5
Period average	3.8	2.0	0.2	2.3	3.2	2.0	2.5
Exports (U.S. dollars)	14.3	0.8	9.1	17.1	22.9	4.1	8.8
Imports (U.S. dollars)	9.1	-1.8	2.2	10.8	8.0	5.6	8.0
Terms of trade	-2.1	-1.8	2.5	2.5	9.1	-0.9	-0.1
Real effective exchange rate (depreciation -) 1/	7.2	4.4	-5.5	-10.7	...	...	...
Money and credit 2/							
Liabilities to the private sector 3/	3.9	7.8	8.7	13.5	9.3	11.3	11.8
Credit to the private sector 3/	-1.2	-2.0	2.1	3.7	3.1	4.8	4.6
			(In percent of GDP, unless otherwise indicated)				
Public sector							
General government current revenue	17.7	17.2	17.2	17.4	17.4	17.5	17.6
Of which : Central government tax revenue	12.0	12.2	11.9	13.0	13.3	13.5	13.5
General government noninterest expenditure	18.3	17.8	17.3	17.1	16.7	16.3	16.2
Of which : capital expenditure	3.8	3.3	2.8	2.7	2.7	2.6	2.7
Combined public sector primary balance	-0.8	0.0	0.0	0.4	0.8	1.4	1.5
Interest due	2.4	2.2	2.1	2.2	2.2	2.4	2.5
Combined public sector overall balance	-3.3	-2.3	-2.2	-1.7	-1.4	-1.0	-1.0
Balance of payments							
Current account	-2.9	-2.2	-2.1	-1.8	-0.7	-0.8	-0.7
Capital and financial account	2.7	3.0	3.5	2.5	0.8	0.9	0.8
Gross reserves							
in millions of U.S. dollars 4/	8,562	8,837	9,690	10,206	10,306	10,406	10,506
percent of short-term external debt 5/	155.6	147.3	216.3	221.8	225.5	223.8	207.8
percent of foreign currency deposits at banks	91.9	92.2	99.8	107.9	107.3	106.6	106.0
Debt							
Total external debt	52.7	50.7	49.3	48.7	45.9	45.1	43.2
Public debt	45.9	46.6	47.1	47.6	44.7	43.0	41.1
Domestic	9.0	10.8	10.3	10.2	9.3	8.3	8.0
External 6/	36.9	35.8	36.9	37.3	35.4	34.7	33.1
Savings and investment							
Gross domestic investment	20.1	18.6	18.4	18.5	18.2	18.6	18.9
Public sector	4.0	3.1	2.8	2.8	2.9	2.9	2.9
Private sector	16.1	15.5	15.6	15.7	15.4	15.8	16.0
National savings	17.2	16.4	16.3	16.7	17.5	17.8	18.2
Public sector 7/	0.8	0.7	0.6	1.1	1.4	1.9	1.9
Private sector	16.4	15.7	15.7	15.6	16.1	15.9	16.3
External savings	2.9	2.2	2.1	1.8	0.7	0.8	0.7
Memorandum item:							
Nominal GDP (S/. billions)	186.8	188.2	198.4	212.2	231.6	246.7	264.5

Sources: Central Reserve Bank of Peru; and Fund staff estimates and projections.

1/ End of period. Based on Information Notice System.
2/ Corresponds to the financial system.
3/ Foreign currency stocks are valued at program exchange rate.
4/ Gross international reserves exceed net international reserves, basically by the stock of Fund credit
5/ Short-term debt includes amortization of medium- and long-term loans falling due over the followi
6/ Includes Central Reserve Bank of Peru debt.
7/ Excludes privatization receipts.

Table 2. Peru: Fiscal Operations of the Combined Public Sector

(In percent of GDP)

	1999	2000	2001	2002	Prel. 2003	Programmed 2004	2005	2006
Central government primary balance	**-1.0**	**-0.5**	**-0.7**	**-0.2**	**0.2**	**0.6**	**1.1**	**1.2**
Revenue	14.9	15.0	14.4	14.4	14.9	15.0	15.2	15.3
Current	14.5	14.7	14.2	14.3	14.8	15.0	15.1	15.2
Of which: tax revenue 1/	12.3	12.0	12.2	11.9	13.0	13.3	13.5	13.5
Of wich: financial transaction tax	...	...	...	...	...	0.3	0.3	0.2
Capital	0.4	0.3	0.2	0.2	0.2	0.1	0.1	0.1
Noninterest expenditure	15.9	15.5	15.1	14.6	14.8	14.5	14.1	14.1
Current	12.5	12.7	12.7	12.6	12.8	12.6	12.3	12.1
Capital	3.4	2.8	2.4	2.0	1.9	1.9	1.8	1.9
Rest of the general government primary balance	**0.1**	**0.2**	**0.3**	**0.2**	**0.3**	**0.2**	**0.2**	**0.2**
Revenue	5.4	5.6	5.7	5.7	5.7	5.5	5.5	5.4
Current	5.4	5.4	5.5	5.7	5.6	5.5	5.4	5.4
Capital	0.0	0.1	0.1	0.1	0.1	0.0	0.0	0.0
Noninterest expenditure	5.3	5.4	5.4	5.5	5.4	5.4	5.3	5.2
Current	4.3	4.4	4.5	4.8	4.6	4.6	4.5	4.4
Capital	1.0	1.0	0.9	0.8	0.8	0.8	0.8	0.8
Public enterprise primary balance	**0.0**	**-0.5**	**0.2**	**-0.1**	**-0.1**	**0.1**	**0.1**	**0.1**
Current balance	0.9	0.2	0.6	0.2	0.3	0.4	0.4	0.4
Capital balance	-0.9	-0.7	-0.4	-0.3	-0.4	-0.3	-0.3	-0.3
Nonfinancial public sector primary balance	-0.8	-0.8	-0.2	-0.2	0.4	0.8	1.4	1.5
Central bank operating balance	0.1	0.0	0.2	0.2	0.1	0.0	0.0	0.0
Combined public sector primary balance	**-0.7**	**-0.8**	**0.0**	**0.0**	**0.4**	**0.8**	**1.4**	**1.5**
Interest payments	2.3	2.4	2.2	2.2	2.2	2.2	2.4	2.5
External	2.0	1.9	2.0	1.8	1.8	1.8	2.0	2.1
Domestic	0.4	0.5	0.3	0.4	0.4	0.4	0.4	0.4
Of which: pension recognition bonds	0.2	0.2	0.0	0.1	0.1	0.1	0.1	0.1
Combined public sector overall balance	**-3.1**	**-3.3**	**-2.3**	**-2.2**	**-1.7**	**-1.4**	**-1.0**	**-1.0**
Financing	3.1	3.3	2.3	2.2	1.7	1.4	1.0	1.0
External	-0.1	1.2	0.9	2.1	1.4	1.0	1.2	0.2
Disbursements 2/	1.6	2.4	2.5	5.1	3.5	3.0	3.1	2.2
(In millions of U.S. dollars)	*812*	*1,299*	*1,319*	*2,863*	*2,100*	*1,961*	*2,200*	*1,600*
Amortizations	-1.7	-1.2	-1.4	-3.2	-2.0	-2.0	-2.0	-2.0
(In millions of U.S. dollars)	*-873*	*-636*	*-768*	*-1,837*	*-1,188*	*-1,335*	*-1,404*	*-1,477*
Rescheduling/arrears (net)	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Condonations	0.1	0.1	-0.1	0.3	-0.1	0.0	0.0	0.0
Domestic	2.5	1.3	0.8	-0.6	0.2	0.2	-0.2	0.8
Bond placements	...	...	0.6	0.5	0.8	0.8	0.9	0.9
(In millions of U.S. dollars)	...	...	*348*	*267*	*512*	*552*	*600*	*650*
Amortizations 3/	...	-0.4	-0.4	-0.3	-0.9	-0.9	-1.2	-0.8
(In millions of U.S. dollars)	...	*-205*	*-197*	*-193*	*-556*	*-587*	*-842*	*-542*
Of which: pension recognition bonds	-40	-44	-52	-55	-175	-235	-165	-109
Net deposits	2.5	1.7	0.5	-0.8	0.3	0.3	0.1	0.6
(In millions of U.S. dollars)	*1,273*	*922*	*255*	*-440*	*192*	*193*	*83*	*447*
Privatization	0.7	0.8	0.6	0.8	0.1	0.2	0.1	0.0
(In millions of U.S. dollars)	*363*	*409*	*327*	*421*	*52*	*111*	*43*	*20*
Memorandum items: 2/								
Overall fiscal deficit (old definition) 4/	-3.0	-3.2	-2.4	-2.2	-1.9	-1.6	-1.1	-1.0
Tax on assest on public enterprises	...	...	0.3	0.2	0.0	0.0	0.0	0.0
General government current revenue 5/	17.5	17.7	17.2	17.2	17.4	17.4	17.5	17.6
General government noninterest expenditure 5/	18.8	18.3	17.8	17.3	17.1	16.7	16.3	16.2
Public sector debt-to-GDP	48.0	45.9	46.6	47.1	47.6	44.6	42.9	41.0

Sources: Central Reserve Bank of Peru; Ministry of Economy and Finance; and IMF staff estimates.

1/ Net of tax on assets of public enterprises and of central government IES payment (0.2 percent of GDP in 2002 and 0 in 2003 as the tax on assests of public enterprises has been phased out).

2/ Includes the Brady bond swap of US$923 million carried out in early 2002.

3/ Includes in 2005 the amortization of US$ 390 million U.S. dollar denominated domestic bonds for the restructuring of the financial sector.

4/ Adjusted by adding the amortization (previously booked as a current transfer) and subtracting the accrued interest payments of CPI-indexed pension recogniton bonds.

5/ Net of transfers among non-financial public institutions.

Table 3. Peru: Fiscal Operations of the Central Government
(In percent of GDP)

	1999	2000	2001	2002	Prel. 2003	Programmed 2004	2005	2006
Current primary balance	**2.0**	**2.0**	**1.5**	**1.6**	**2.0**	**2.4**	**2.8**	**3.1**
Current revenue	14.5	14.7	14.2	14.3	14.8	15.0	15.1	15.2
Tax revenue 1/	12.3	12.0	12.2	11.9	13.0	13.3	13.5	13.5
Direct taxes	3.5	3.3	3.4	3.2	4.0	3.9	3.9	3.9
Indirect taxes	8.9	8.7	8.8	8.7	9.0	9.4	9.6	9.7
Of which: financial transaction tax	...	...	...	...	...	0.3	0.3	0.2
Other current revenue 2/	2.2	2.8	2.0	2.4	1.8	1.6	1.6	1.7
Current noninterest expenditure	12.5	12.7	12.7	12.6	12.8	12.6	12.3	12.1
Labor services 3/	6.7	6.6	6.7	6.7	6.7	6.5	6.5	6.3
Goods and nonlabor services	3.0	3.8	3.8	3.4	3.5	3.4	3.2	3.2
Transfers and other	2.7	2.3	2.2	2.5	2.6	2.7	2.7	2.7
Capital balance	**-3.0**	**-2.5**	**-2.2**	**-1.9**	**-1.8**	**-1.8**	**-1.7**	**-1.8**
Capital revenue	0.4	0.3	0.2	0.2	0.2	0.1	0.1	0.1
Capital expenditure	3.4	2.8	2.4	2.0	1.9	1.9	1.8	1.9
Gross capital formation	2.7	2.5	2.1	1.8	1.7	1.7	1.6	1.8
Other	0.7	0.3	0.3	0.2	0.3	0.2	0.2	0.2
Primary balance	**-1.0**	**-0.5**	**-0.7**	**-0.2**	**0.2**	**0.6**	**1.1**	**1.2**
Interest payments	2.1	2.2	2.2	2.0	2.0	2.0	2.3	2.3
External	2.0	1.9	1.9	1.8	1.8	1.8	2.0	2.1
Domestic	0.1	0.3	0.2	0.2	0.2	0.2	0.2	0.3
Overall balance	**-3.1**	**-2.7**	**-2.8**	**-2.2**	**-1.8**	**-1.5**	**-1.1**	**-1.1**
Memorandum items:								
General Government Tax Revenues 1/	12.6	12.2	12.5	12.2	13.0	13.6	13.7	13.8
Primary balance before transfers	0.6	0.9	1.2	1.9	2.7	3.1	3.7	3.8
Overall balance before transfers	-1.5	-1.3	-1.0	-0.1	0.7	1.1	1.5	1.5
Tax compliance rate 4/	...	79	83	87	...	...	...	...

Sources: Central Reserve Bank of Peru; Ministry of Economy and Finance; and IMF staff estimates.

1/ Net of tax on assets of public enterprises and of central government IES payment.

2/ The decline in 2003 reflects lower collections on the recovery of illicit funds from officials of the previous administration and special large fines paid by mining companies in 2002.

3/ Includes wages, salaries, and employer contributions to social security.

4/ Measured as the ratio between paid tax obligations and total tax obligations. Obligations covered as VAT and income tax for large taxpayers only.

Table 4. Peru: Financing of the Combined Public Sector

	2001	2002	Prel. 2003	Programmed 2004	2005	2006
			(In millions of U.S. dollars)			
Combined balance	**-1212**	**-1230**	**-1049**	**-927**	**-710**	**-725**
Financing	**1212**	**1230**	**1049**	**927**	**710**	**725**
Net External	479	1169	837	657	825	150
Disbursements 1/	1319	2863	2100	1961	2200	1600
Bonds	0	1886	1245	500	1000	600
Multilaterals	1105	807	519	1012	700	500
Bilaterals and other	214	170	336	449	500	500
Amortizations 1/	-768	-1837	-1188	-1335	-1404	-1477
Condonation	-72	143	-75	31	29	27
Privatization	**327**	**421**	**52**	**111**	**43**	**20**
Net Domestic financing	**406**	**-360**	**160**	**159**	**-158**	**555**
Bonds	348	267	512	552	600	650
Amortizations	-197	-193	-556	-587	-842	-542
Of which : pension recognition bonds	-52	-55	-175	-235	-165	-109
Net deposits	255	-433	204	193	84	447
Of which: Central government	228	-393	305	221	168	550
			(In percent of GDP)			
Combined balance	-2.3	-2.2	-1.7	-1.4	-1.0	-1.0
Financing	2.3	2.2	1.7	1.4	1.0	1.0
Net External	0.9	2.1	1.4	1.0	1.2	0.2
Disbursements 1/	2.5	5.1	3.4	3.0	3.1	2.2
Bonds	0.0	3.3	2.0	0.8	1.4	0.8
Multilaterals	2.1	1.4	0.9	1.5	1.0	0.7
Bilaterals and other	0.4	0.3	0.6	0.7	0.7	0.7
Amortizations 1/	-1.4	-3.3	-2.0	-2.0	-2.0	-2.0
Condonation	-0.1	0.3	-0.1	0.0	0.0	0.0
Privatization	0.6	0.7	0.1	0.2	0.1	0.0
Net Domestic financing	0.8	-0.6	0.3	0.2	-0.2	0.8
Bonds	0.6	0.5	0.8	0.8	0.9	0.9
Amortizations 2/	-0.4	-0.3	-0.9	-0.9	-1.2	-0.7
Of which: pension recognition bonds	0.1	0.1	0.3	0.4	0.2	0.1
Net deposits	0.5	-0.8	0.3	0.3	0.1	0.6
Of which: Central government	0.4	-0.7	0.5	0.3	0.2	0.7

Sources: Central Reserve Bank of Peru; Ministry of Economy and Finance; and IMF staff estimates.
1/ Includes the Brady bond swap of US$923 million carried out in early 2002.
2/ Includes in 2005 the amortization of US$390 million U.S. dollar denominated domestic bonds for the restructuring of the financial sector.

Table 5. Peru: Public Sector Social Expenditure

	1999	2000	2001	2002	Prel. 2003
Total social expenditure and pensions	**17,780**	**18,821**	**19,056**	**20,480**	**21,755**
Universal coverage (Education and Health) 1/	6,840	7,106	7,135	7,987	9,088
Education	4,737	5,004	5,165	5,737	6,315
Health	2,103	2,102	1,970	2,250	2,773
Targeted programs (Extreme Poverty)	3,257	3,043	2,986	2,840	2,938
Non-Targeted Social Programs	7,683	8,672	8,935	9,653	9,729
ESSALUD	2,489	2,836	2,775	2,961	3,039
Pensions	5,104	5,855	6,108	6,644	6,674
Housing Development Program (FONAVI)	90	-19	52	48	16
(In percent of general government expenditure)					
Total social expenditure and pensions	**48.3**	**48.7**	**50.7**	**53.0**	**53.4**
Universal coverage (Education and Health) 1/	18.6	18.4	19.0	20.7	22.3
Education	12.9	13.0	13.7	14.9	15.5
Health	5.7	5.4	5.2	5.8	6.8
Targeted programs (Extreme Poverty)	8.8	7.9	7.9	7.4	7.2
Non-Targeted Social Programs	20.9	22.4	23.8	25.0	23.9
ESSALUD	6.8	7.3	7.4	7.7	7.5
Pensions	13.9	15.2	16.2	17.2	16.4
Housing Development Program (FONAVI)	0.2	0.0	0.1	0.1	0.0
(In percent of GDP)					
Total social expenditure and pensions	**10.2**	**10.1**	**10.1**	**10.3**	**10.3**
Universal coverage (Education and Health) 1/	3.9	3.8	3.8	4.0	4.3
Education	2.7	2.7	2.7	2.9	3.0
Health	1.2	1.1	1.0	1.1	1.3
Targeted programs (Extreme Poverty)	1.9	1.6	1.6	1.4	1.4
Non-Targeted Social Programs	4.4	4.6	4.7	4.9	4.6
ESSALUD	1.4	1.5	1.5	1.5	1.4
Pensions	2.9	3.1	3.2	3.3	3.2
Housing Development Program (FONAVI)	0.1	0.0	0.0	0.0	0.0
Memorandum items:					
(In millions of soles)					
General government expenditure	36,821	38,636	37,613	38,622	40,765
Nominal GDP	174,719	186,756	188,172	198,436	211,809
Defense and national security	2.8	2.9	2.5	2.2	2.3
Justice	0.4	0.4	0.4	0.4	0.4

Source: Peruvian authorities.

1/ Net of spending on education and health already included in the extreme poverty programs.

Table 6. Peru: Balance of Payments

	2000	2001	2002	Prel. 2003	Programmed 2004	2005	2006
(In millions of U.S. dollars)							
Current account	**-1,557**	**-1,183**	**-1,207**	**-1,116**	**-453**	**-582**	**-491**
Merchandise trade	-456	-267	207	710	2,103	2,057	2,316
Exports	6,951	7,007	7,647	8,954	11,009	11,466	12,475
Traditional	4,821	4,742	5,312	6,281	7,982	8,031	8,596
Nontraditional and others	2,130	2,265	2,335	2,673	3,027	3,435	3,879
Imports	-7,407	-7,273	-7,440	-8,244	-8,906	-9,409	-10,159
Services, income, and current transfers (net)	-1,101	-916	-1,414	-1,826	-2,556	-2,639	-2,807
Services	-691	-835	-948	-996	-1,053	-1,022	-1,096
Investment income	-1,409	-1,123	-1,509	-2,073	-2,711	-2,853	-2,989
Current transfers	999	1,042	1,043	1,243	1,208	1,236	1,278
Financial and capital account	**1,426**	**1,601**	**1,987**	**1,536**	**521**	**653**	**564**
Public sector	280	394	1,051	679	543	754	197
Disbursements 1/	1,485	1,344	2,902	2,155	2,037	2,250	1,750
Amortization 1/	-1,042	-918	-1,888	-1,228	-1,375	-1,440	-1,502
Other medium- and long-term public sector flows 2/	-163	-32	37	-248	-119	-56	-51
Capital transfers (net)	0	0	0	0	0	0	0
Privatization	229	267	186	10	10	10	10
Private sector	917	940	750	847	-32	-111	357
Foreign direct investment (FDI) excluding privatization	581	803	2,205	1,322	1,100	1,200	1,293
Other private capital	336	137	-1,455	-475	-1,132	-1,311	-936
Medium- and long-term loans	962	197	-173	-13	200	196	179
Portfolio investment	-314	-300	-495	-1,221	-1,012	-1,520	-1,110
Short-term flows to the financial system 3/	-9	-358	-474	103	-100	0	0
Other short term flows (including errors and omissions)	-303	598	-313	656	-220	13	-5
Financing	**131**	**-418**	**-780**	**-420**	**-68**	**-71**	**-73**
NIR flow (increase -)	190	-448	-832	-478	-100	-100	-100
Change in NIR (increase -)	224	-433	-985	-596	-100	-100	-100
Valuation change	34	15	-153	-118	0	0	0
Exceptional financing	-59	30	52	58	32	29	27
Debt relief 4/	0	33	51	31	32	29	27
Rescheduling	0	54	0	0	0	0	0
Change in arrears	-59	-57	0	0	0	0	0
(In percent of GDP unless otherwise specified)							
Memorandum items:							
Current account (CA) balance	**-2.9**	**-2.2**	**-2.1**	**-1.8**	**-0.7**	**-0.8**	**-0.7**
FDI and private MLT capital (percent of CA deficit)	99.1	84.6	168.4	117.3	287.0	239.7	299.8
Capital and financial account balance	2.7	3.0	3.5	2.5	0.8	0.9	0.8
Export value (US$), percent change	14.1	0.8	9.1	17.1	22.9	4.1	8.8
Volume growth	10.5	5.8	5.0	8.4	9.0	6.4	7.6
Price growth	3.3	-4.8	3.6	8.1	13.0	-2.1	1.1
Import value (US$), percent change	9.1	-1.8	2.3	10.8	8.0	5.6	8.0
Volume growth	3.7	1.4	1.1	5.1	4.3	6.9	6.7
Price growth	5.3	-3.1	1.1	5.5	3.6	-1.2	1.2
GDP (billions of US$)	53.1	53.6	56.4	61.0	66.3	69.9	74.1

Sources: Central Reserve Bank of Peru; Ministry of Economy and Finance; and Fund staff estimates and projections.

1/ In 2002, includes the Brady Bond swap (not envisaged in the original program). For details of the swap, see Country Report No. 03/72, Box 3.

2/ Includes medium- and long-term flows of the financial public sector and subscription payments into international funds.

3/ Includes COFIDE and Banco de la Nación. Outflows in 2002 reflect a further reduction in the financial system's short-term debt.

4/ Debt relief for 2002-2003 from Paris Club creditors.

Table 7. Peru: External Financing Requirements and Sources
(In millions of U.S. dollars)

				Prel.	Programmed		
	2000	2001	2002	2003	2004	2005	2006
1. Gross financing requirements	**8,136**	**7,135**	**8,041**	**6,063**	**5,155**	**5,253**	**5,241**
External current account deficit (excluding official transfers)	1,557	1,183	1,207	1,116	453	582	491
Debt amortization	6,711	5,502	6,002	4,469	4,602	4,571	4,650
Medium- and long-term debt	1,980	1,762	2,770	1,879	2,075	2,144	2,223
Public sector	1,042	918	1,888	1,228	1,375	1,440	1,502
Multilateral 1/	531	334	399	486	573	595	634
Bilateral	388	489	541	686	724	744	734
Bonds and notes	108	83	940	50	68	93	90
Other	14	12	8	6	10	8	44
Private sector	938	844	882	651	700	704	721
Short-term debt 2/	4,731	3,740	3,232	2,590	2,527	2,427	2,427
Repayment of arrears 3/	58	2	0	0	0	0	0
Accumulation of NIR (flow)	-190	448	832	478	100	100	100
Change in gross reserves	-440	276	852	516	100	100	100
Payments of short-term liabilities incl. IMF	216	158	133	92	0	0	0
Valuation adjustment	34	15	-153	-64	0	0	0
2. Available financing	**8,136**	**7,135**	**8,041**	**6,063**	**5,155**	**5,253**	**5,241**
Foreign direct investment (net)	810	1,070	2,391	1,332	1,110	1,210	1,303
Privatization	229	267	186	10	10	10	10
FDI	581	803	2,205	1,322	1,100	1,200	1,293
Portfolio (net)	-314	-300	-495	-1,221	-1,012	-1,520	-1,110
Short-term assets (flow)	679	748	-144	822	-221	15	-3
Debt financing from private creditors	5,674	4,273	5,185	4,411	3,827	4,342	4,047
Medium- and long-term financing	1,934	1,041	2,595	1,884	1,400	1,915	1,620
To public sector	34	0	1,886	1,246	500	1,015	720
To private sector	1,900	1,041	709	638	900	900	900
Short-term financing	3,740	3,232	2,590	2,527	2,427	2,427	2,427
Official creditors 4/	1,450	1,343	1,016	909	1,538	1,233	1,028
Multilateral 1/	794	1,104	807	699	1,307	960	750
Of which : balance of payments financing	471	0	625	519	1,011	700	500
Bilateral	656	239	209	210	231	273	278
To public sector	656	239	209	210	231	273	278
Of which : balance of payments financing	300	0	0	0	0	0	0
To private sector	0	0	0	0	0	0	0
Other medium- and long-term public sector flows 5/	-163	1	88	-190	-87	-27	-24
IMF	0	0	0	0	0	0	0
Accumulation of arrears (exceptional)	0	0	0	0	0	0	0

Sources: Central Reserve Bank of Peru; and Fund staff estimates and projections.

1/ Excluding IMF.
2/ Original maturity of less than one year. Equals stock at the end of the previous period. Excludes BCRP short-term debt.
3/ Most of the external arrears are owed to unguaranteed suppliers, some of which are in discussions with the government, while the rest
4/ Includes both loans and grants.
5/ Includes subscription payments to international organizations and changes in Banco de la Nación's long-term assets.

Table 8. Peru: Monetary Survey

	2000	2001	2002	Prel. 2003	Programmed 2004	2005	2006
			I. Central Reserve Bank				
			(In millions of Nuevos Soles at program exchange rate)				
Net international reserves 1/	**28,739**	**29,803**	**32,954**	**35,361**	**34,968**	**35,671**	**36,432**
(In millions of U.S. dollars)	8,022	8,324	9,309	9,905	10,005	10,105	10,205
Net domestic assets	**-24,201**	**-24,858**	**-27,339**	**-28,991**	**-28,120**	**-28,302**	**-28,491**
Net credit to nonfinancial public sector	-9,390	-8,758	-10,147	-10,709	-9,865	-9,318	-8,565
Rest of banking system	-12,488	-13,695	-14,128	-14,885	-15,303	-15,838	-16,263
Other	-2,323	-2,405	-3,063	-3,397	-2,951	-3,146	-3,662
Currency	**4,537**	**4,945**	**5,615**	**6,370**	**6,848**	**7,369**	**7,941**
			II. Banking System				
			(In millions of Nuevos Soles at program exchange rate)				
Net foreign assets	**26,555**	**28,503**	**33,300**	**35,010**	**35,709**	**36,062**	**36,419**
Net domestic assets	**21,043**	**21,004**	**18,407**	**17,699**	**19,924**	**22,334**	**24,967**
Net credit to nonfinancial public sector	-11,297	-9,351	-10,532	-10,664	-9,997	-9,120	-7,999
Credit to private sector	49,112	47,611	46,890	45,262	46,831	48,552	50,448
Other	-16,772	-17,256	-17,951	-15,362	-16,910	-17,098	-17,482
Net credit to COFIDE	-2,395	-1,732	-1,340	-1,018	-1,018	-1,018	-1,018
Other	-14,377	-15,524	-16,611	-14,175	-15,892	-16,080	-16,464
Liabilities to the private sector	**47,598**	**49,507**	**51,707**	**52,709**	**55,633**	**58,395**	**61,386**
			(12-month percentage change) 2/				
Base money	-4.0	7.9	11.0	10.1	8.0	8.0	8.0
Broad money	2.3	4.9	3.6	2.5	4.1	5.5	5.7
Domestic currency	2.5	13.7	10.6	10.5	12.0	10.0	10.0
Foreign currency	2.2	1.1	1.4	-2.6	1.6	1.6	1.5
Credit to private sector	-3.6	-2.6	-2.4	-2.8	1.9	4.5	4.8
Domestic currency	0.9	2.9	7.1	5.1	12.0	12.0	12.1
Foreign currency	-4.5	-3.8	-3.6	-5.8	1.0	1.0	1.0
			III. Financial System				
			(In millions of Nuevos Soles at program exchange rate)				
Net foreign assets	**26,708**	**30,931**	**37,354**	**44,893**	**45,592**	**45,945**	**46,302**
Net domestic assets	**29,180**	**29,503**	**28,499**	**30,212**	**32,438**	**34,847**	**37,259**
Net credit to the public sector	-11,600	-8,581	-9,697	-8,976	-8,309	-7,432	-6,311
Credit to private sector	60,374	59,191	60,422	62,666	64,235	65,955	67,852
Other	-19,594	-21,106	-22,226	-23,478	-23,488	-23,677	-24,282
Liabilities to the private sector	**55,888**	**60,435**	**65,854**	**75,105**	**78,029**	**80,792**	**83,560**
			(12-month percentage change) 2/				
Liabilities to the private sector	3.9	7.8	8.7	13.5	9.3	11.3	11.8
Domestic currency	6.4	18.0	17.2	24.3	17.5	17.5	17.5
Foreign currency	2.3	1.0	3.2	2.9	2.5	2.4	2.4
Credit to private sector	-1.2	-2.0	2.1	3.7	3.1	4.8	4.6
Domestic currency	2.3	5.6	18.9	18.0	18.3	14.7	12.8
Foreign currency	-2.2	-4.2	-2.2	-2.7	-2.0	-2.0	-2.1
Memorandum item:							
Program exchange rate (S/. per US$)	3.60	3.58	3.54	3.57	...	...	...

Sources: Central Reserve Bank of Peru; and Fund staff estimates and projections.

1/ Excludes subscriptions to the IMF and the Latin American Reserve Fund (FLAR), Pesos Andinos, credit lines to other central banks, Corporación Andina de Fomento (CAF) bonds, and foreign assets temporarily held by the BCRP as part of swap operations.
2/ Flows in foreign currency are valued at the program exchange rate.

Table 9. Peru: Financial and External Vulnerability Indicators
(In percent; unless otherwise indicated)

				Prel.	Projected		
	2000	2001	2002	2003	2004	2005	2006
Financial indicators							
Public sector debt/GDP	45.9	46.6	47.1	47.6	44.7	43.0	41.1
Of which: in domestic currency (percent of GDP)	4.6	4.7	5.7	5.7	7.2	6.9	6.6
90-day prime lending rate, domestic currency (end of period)	15.4	5.0	5.1	3.3	...	...	...
90-day prime lending rate, foreign currency (end of period)	8.2	3.1	2.4	1.7	...	...	...
Velocity of money 1/	3.9	3.7	3.8	3.9	4.0	4.0	4.0
Credit to the private sector/GDP 2/	32.3	31.5	30.4	29.5	27.3	26.5	25.7
Share of foreign currency deposits in total deposits	76.9	74.3	73.2	70.4	68.3	65.0	62.0
Share of foreign currency loans in total credit	81.5	80.9	79.0	77.3	75.1	73.3	71.4
Nonperforming loans/total loans 3/ 4/	11.2	11.0	9.1	8.3	...	...	...
Loan-loss provisions/nonperforming loans 3/ 4/	78.5	91.1	112.2	116.2	...	...	...
Risk-based capital-assets ratio (end of period) 3/	12.9	13.2	12.7	13.8	…	…	…
Foreign currency deposits at commercial banks (in millions of U.S. dollars)	9,260	9,451	9,562	9,459	9,609	9,759	9,909
Commercial banks' short-term foreign assets (in millions of U.S. dollars)	824	748	779	601	779	779	779
Commercial banks' short-term foreign liabilities (in millions of U.S. dollars)	1,519	1,161	763	702	763	763	763
External indicators							
Exports, U.S. dollars (percent change)	14.3	0.8	9.1	17.1	22.9	4.1	8.8
Imports, U.S. dollars (percent change)	9.1	-1.8	2.3	10.8	8.0	5.6	8.0
Terms of trade (percent change)	-2.1	-1.8	2.5	2.5	9.1	-0.9	-0.1
Real effective exchange rate, (end of period, percent change) 3/	7.2	4.4	-5.5	-10.7	...	...	...
Current account balance (percent of GDP)	-2.9	-2.2	-2.1	-1.8	-0.7	-0.8	-0.7
Capital and financial account balance (percent of GDP)	2.7	3.0	3.5	2.5	0.8	0.9	0.8
Total external debt (percent of GDP)	52.7	50.7	49.3	48.7	45.9	45.1	43.2
Medium- and long-term public debt (percent of GDP) 5/	36.9	35.8	36.9	37.3	35.4	34.7	33.1
Medium- and long-term private debt (percent of GDP)	8.8	8.9	7.9	7.2	6.9	6.9	6.9
Short-term public and private debt (percent of GDP)	7.0	6.0	4.6	4.1	3.7	3.5	3.3
Total external debt (percent of exports of goods and services) 5/	327.1	319.3	302.9	281.9	239.9	237.7	223.0
Total debt service (percent of exports of goods and services) 6/	44.2	39.9	34.8	30.6	28.3	29.5	29.0
Gross official reserves (in millions of U.S. dollars)	8,562	8,838	9,690	10,206	10,306	10,406	10,506
Gross official reserves, percent of short-term external debt 7/	155.6	147.3	216.8	221.8	225.5	223.8	207.8
Gross official reserves, percent of broad money 8/	64.0	62.1	65.2	67.7	66.9	68.2	69.6
Gross official reserves, percent of foreign currency deposits at banks	91.9	92.2	99.8	107.9	107.3	106.6	106.0
Gross official reserves (in months of imports of goods and services)	10.7	10.7	10.5	10.5	10.1	9.5	9.2
Net international reserves (in millions of U.S. dollars)	8,180	8,613	9,598	10,194	10,294	10,394	10,494
Net international reserves (program definition; in millions of U.S. dollars) 9/	4,891	5,056	5,674	6,631	6,474	6,465	6,456
Net international position (in millions of U.S. dollars) 10/	2,624	2,915	3,341	4,583	4,683	4,783	4,883
Financial market indicators							
Stock market index (U.S. dollars)	342.8	342.1	396.0	700.6	…	…	…
Foreign currency debt rating (Moody's)	Ba3	Ba3	Ba3	Ba3	…	…	…
Spread of Peruvian Brady bonds, basis points 11/	687	521	610	312	…	…	…

Sources: Central Reserve Bank of Peru; and Fund staff estimates and projections.

1/ Defined as the inverse of the ratio of end-period broad money to annual GDP.
2/ Corresponds to the financial system.
3/ End of period.
4/ Annual average. Since 2000, includes adjustment for an estimate of nonperforming loans that were temporarily exchanged for government bonds.
5/ Includes Central Reserve Bank of Peru debt.
6/ Includes debt service to the Fund. For 2002, excludes US$923 million of Brady bonds that were amortized in a debt exchange operation.
7/ Short-term debt includes amortization of medium- and long-term loans falling due over the following year.
8/ At end-period exchange rate.
9/ Includes financial system's foreign currency deposits in central bank as reserve liability.
10/ Includes public sector foreign currency deposits in central bank (e.g. pension reserve funds) as reserve liability.
11/ Over U.S. Treasury bond yields of comparable maturity.

Table 10. Peru: Medium-Term Outlook

			Prel.	Projections									
	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
	I. Balance of Payments and Other External Indicators												
	(In billions of U.S. dollars)												
Current account	**-1.2**	**-1.2**	**-1.1**	**-0.5**	**-0.6**	**-0.5**	**-0.6**	**-0.5**	**-0.6**	**-0.5**	**-0.5**	**-0.4**	**-0.4**
Merchandise trade	-0.3	0.2	0.7	2.1	2.1	2.3	2.5	2.7	2.9	3.2	3.5	3.9	3.9
Exports	7.0	7.6	9.0	11.0	11.5	12.5	13.1	14.1	15.0	16.3	17.5	18.9	19.9
Imports	-7.3	-7.4	-8.2	-8.9	-9.4	-10.2	-10.6	-11.4	-12.2	-13.0	-14.0	-15.0	-16.0
Services	-0.8	-0.9	-1.0	-1.1	-1.0	-1.1	-1.2	-1.2	-1.2	-1.3	-1.3	-1.4	-1.4
Investment income	-1.1	-1.5	-2.1	-2.7	-2.9	-3.0	-3.3	-3.4	-3.5	-3.7	-4.0	-4.2	-4.2
Current transfers	1.0	1.0	1.2	1.2	1.2	1.3	1.3	1.3	1.3	1.3	1.3	1.3	1.3
Capital and financial account	**1.6**	**2.0**	**1.5**	**0.5**	**0.7**	**0.6**	**0.7**	**0.6**	**0.7**	**0.6**	**0.6**	**0.5**	**0.5**
Public sector	0.4	1.1	0.7	0.5	0.8	0.2	0.2	0.2	0.2	0.2	0.2	-0.2	0.1
Disbursements 1/	1.3	2.9	2.2	2.0	2.3	1.8	1.8	1.8	1.8	1.8	2.0	2.3	2.0
Amortization due 1/	-0.9	-1.9	-1.2	-1.4	-1.4	-1.5	-1.6	-1.6	-1.6	-1.6	-1.7	-2.5	-1.8
Other medium- and long-term public flows 2/	0.0	0.0	-0.2	-0.1	-0.1	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Private sector	1.2	0.9	0.3	0.2	-0.1	0.4	0.5	0.4	0.5	0.4	0.4	0.7	0.4
Privatization receipts from direct investment	0.3	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Direct investment, excluding privatization	0.8	2.2	1.3	1.1	1.2	1.3	0.8	0.9	1.0	1.1	1.0	1.0	0.9
Other 3/	0.1	-1.5	-0.5	-1.1	-1.3	-0.9	-0.3	-0.4	-0.5	-0.7	-0.6	-0.3	-0.5
Overall balance	**0.4**	**0.8**	**0.4**	**0.1**	**0.1**	**0.1**	**0.1**	**0.1**	**0.1**	**0.1**	**0.1**	**0.1**	**0.1**
Change in central bank reserves	-0.4	-0.8	-0.5	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Exceptional financing 4/	0.0	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
	(In percent of exports of goods and services)												
Total external debt service 1/ 5/	39.9	34.8	30.6	28.3	29.5	29.0	30.8	29.7	28.6	26.9	26.3	28.5	24.1
Public external debt service 1/ 5/	23.6	31.7	22.0	20.4	21.1	20.6	19.9	19.4	18.9	18.2	18.2	21.0	17.3
Gross reserves													
In U.S.$ billions	8.8	9.7	10.2	10.3	10.4	10.5	10.6	10.7	10.8	10.9	11.0	11.1	11.2
In months of next year's imports of goods and services	10.7	10.7	10.5	10.1	9.5	9.2	8.7	8.2	7.8	7.4	7.0	6.6	6.4
In percent of short-term external debt on a residual-maturity basis	147.3	216.8	221.8	225.5	223.8	207.8	214.0	215.9	220.9	217.9	191.2	223.4	230.0
In percent of broad money	62.1	65.2	67.7	66.9	68.2	69.6	70.5	71.4	72.3	73.2	74.1	75.0	75.9
	(In percent of GDP)												
Current account deficit	-2.2	-2.1	-1.8	-0.7	-0.8	-0.7	-0.7	-0.6	-0.6	-0.5	-0.5	-0.4	-0.4
Merchandise exports	13.1	13.6	14.7	16.6	16.4	16.8	16.7	16.9	16.9	17.2	17.4	17.7	17.6
Merchandise imports	-13.6	-13.2	-13.5	-13.4	-13.5	-13.7	-13.5	-13.6	-13.7	-13.8	-13.9	-14.1	-14.2
Total external debt	50.7	49.3	48.7	45.9	45.1	43.2	40.6	38.3	36.0	34.0	32.2	30.1	28.5
Total medium- and long-term public external debt 6/	35.7	36.8	37.3	35.4	34.7	33.1	31.4	29.8	28.2	26.8	25.4	23.8	22.5

Table 10 (continued). Peru: Medium-Term Outlook

	2001	2002	Prel. 2003	Projections 2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
II. Output and Prices													
(Annual percentage change)													
Real GDP	0.3	4.9	4.0	4.0	4.5	4.5	4.0	4.0	4.0	4.0	4.0	4.0	4.0
Real domestic demand	-0.5	4.1	3.7	3.5	4.5	4.3	3.9	3.9	3.9	3.9	3.9	3.9	3.9
Of which:													
Private consumption	1.4	4.5	3.2	3.5	4.2	4.2	3.8	3.8	3.8	3.8	3.8	3.8	3.8
Private investment	-4.5	0.2	5.2	6.2	6.6	6.8	4.0	4.0	4.0	4.0	4.0	4.0	4.0
Consumer prices (end of period)	-0.1	1.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5
(In percent of GDP)													
III. Savings and Investment													
Gross domestic investment	**18.6**	**18.4**	**18.5**	**18.2**	**18.6**	**18.9**	**18.9**	**18.9**	**18.9**	**18.9**	**18.9**	**18.9**	**18.9**
Public sector	3.1	2.8	2.8	2.9	2.9	2.9	2.9	2.9	2.9	2.9	3.0	3.0	3.0
Private sector	15.5	15.6	15.7	15.4	15.8	16.0	16.0	16.0	16.0	16.0	16.0	15.9	15.9
National savings	**16.4**	**16.3**	**16.7**	**17.5**	**17.8**	**18.2**	**18.2**	**18.3**	**18.3**	**18.4**	**18.4**	**18.5**	**18.5**
Public sector 7/	0.8	0.6	1.1	1.5	1.9	1.9	1.9	1.9	1.9	1.9	2.0	2.0	2.0
Private sector	15.5	15.7	15.6	16.0	15.9	16.3	16.3	16.4	16.4	16.5	16.4	16.5	16.5
External savings	**2.2**	**2.1**	**1.8**	**0.7**	**0.8**	**0.7**	**0.7**	**0.6**	**0.6**	**0.5**	**0.5**	**0.4**	**0.4**
IV. Combined Public Sector													
Combined public sector primary balance	**0.0**	**0.0**	**0.4**	**0.8**	**1.4**	**1.5**	**1.4**	**1.5**	**1.4**	**1.5**	**1.6**	**1.6**	**1.6**
Of which													
General government current rev. 8/	17.2	17.2	17.4	17.4	17.6	17.5	17.2	17.2	17.2	17.1	17.1	17.0	17.0
General govt. non-interest exp. 9/	17.8	17.3	17.1	16.7	16.3	16.1	15.9	15.8	15.8	15.7	15.4	15.4	15.4
Interest due	2.2	2.2	2.2	2.2	2.4	2.5	2.4	2.5	2.5	2.5	2.6	2.7	2.6
Combined public sector overall balance	**-2.3**	**-2.2**	**-1.7**	**-1.4**	**-1.0**	**-1.0**	**-1.0**	**-1.0**	**-1.0**	**-1.0**	**-1.0**	**-1.0**	**-1.0**
Net external financing	0.9	2.1	1.4	1.0	1.2	0.2	0.6	0.7	0.4	0.5	0.4	0.8	0.8
Net domestic financing 10/	0.8	-0.6	0.2	0.2	-0.2	0.7	0.4	0.3	0.6	0.4	0.6	0.2	0.2
Privatization receipts	0.6	0.8	0.1	0.2	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Public sector debt	46.6	47.1	47.6	44.7	43.0	41.1	39.4	37.9	36.5	35.2	34.0	32.8	31.7

Sources: Central Reserve Bank of Peru; and Fund staff estimates and projections.

1/ In 2002, includes the Brady Bond swap (not envisaged in the original program). For details of the swap, see EBS/02/199, Box 3.

2/ Includes portfolio flows of the pension reserve fund and subscription payments into international funds.

3/ Includes errors and omissions.

4/ Includes debt relief from Paris Club creditors, and debt forgiveness.

5/ Spikes in 2008 and 2012 reflect bullet-payment amortizations of international bond issues from 2002 and 2003.

6/ Includes Central Reserve Bank of Peru debt.

7/ Excludes privatization receipts.

8/ Assumes that the financial transactions tax expires at end-2006.

9/ Real expenditure growth is limited to 3 percent a year under the nation's fiscal responsibility law.

10/ Includes statistical discrepancy.

Table 11. Peru: Proposed Schedule of Purchases
Under the Stand-By Arrangement, 2004–06[1]

Amount of Purchase	Availability Date	Conditions Include
1. SDR 80.00 million[2]	June 9, 2004	Board approval of SBA.
2. SDR 23.031 million	August 31, 2004	Observance of end-June 2004 performance criteria.
3. SDR 23.031 million	October 31, 2004	Completion of the First Review and observance of end-September 2004 performance criteria.
4. SDR 23.031 million	February 28, 2005	Completion of the second review and observance of end-December 2004 performance criteria.
5. SDR 23.031 million	May 15, 2005	Observance of end-March 2005 performance criteria.
6. SDR 23.031 million	August 31, 2005	Completion of the third review and observance of end-June 2005 performance criteria.
7. SDR 23.031 million	November 15, 2005	Observance of end-September 2005 performance criteria.
8. SDR 23.031 million	February 28, 2006	Completion of the fourth review and observance of end-December 2005 performance criteria.
9. SDR 23.031 million	May 15, 2006	Observance of end-March 2006 performance criteria.
10. SDR 23.031 million	July 31, 2006	Completion of the fifth review and observance of end-June 2006 performance criteria.

[1] Total access under the Stand-By Arrangement is SDR 287.279 million (20 percent of quota on an annual basis).

[2] This amount is required to bring total disbursements outstanding to above 25 percent of quota.

Table 12. Peru: Capacity to Repay the Fund as of March 31, 2004 1/

(In millions of SDRs)

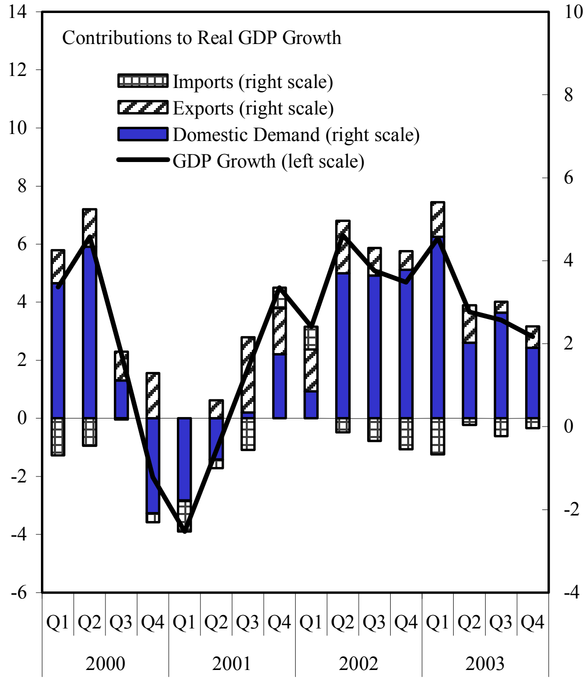
	2004	2005	2006	2007	2008	2009	2010	2011	2012	Total
Obligations from existing drawings										
Principal (repurchases)	26.8	26.8	26.8	13.4	0.0	0.0	0.0	0.0	0.0	93.6
Charges and interest 2/										
GRA charges	1.7	1.2	0.6	0.1	0.0	0.0	0.0	0.0	0.0	3.6
SDR charges	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	13.5
Credit outstanding	66.9	40.2	13.4	0.0	0.0	0.0	0.0	0.0	0.0	120.6
(percent of quota)	10.5	6.3	2.1	0.0	0.0	0.0	0.0	0.0	0.0	18.9
Obligations from prospective drawings										
Principal (repurchases)	0.0	0.0	22.9	80.3	103.5	63.3	17.2	0.0	0.0	287.2
Charges and interest 2/										
GRA charges	1.5	3.9	5.7	5.3	3.3	1.2	0.2	0.0	0.0	21.1
Credit outstanding	126.0	218.1	264.3	184.0	80.5	17.2	0.0	0.0	0.0	890.3
(percent of quota)	19.7	34.2	41.4	28.8	12.6	2.7	0.0	0.0	0.0	139.5
Cumulative (existing and prospective)										
Principal (repurchases)	26.8	26.8	49.7	93.7	103.5	63.3	17.2	0.0	0.0	380.8
Charges and interest 2/										
GRA charges	3.2	5.1	6.3	5.4	3.3	1.2	0.2	0.0	0.0	24.7
SDR charges	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	13.5
Credit outstanding	31.5	33.4	57.5	100.6	108.3	66.0	18.9	1.5	1.5	419.0
(percent of quota)	4.9	5.2	9.0	15.7	16.9	10.3	3.0	0.2	0.2	65.6
(percent of GDP)	0.1	0.1	0.1	0.2	0.2	0.1	0.0	0.0	0.0	…
(percent of exports of goods and services)	0.4	0.4	0.6	1.0	1.0	0.6	0.2	0.0	0.0	…
(percent of public sector debt service)	1.8	1.8	2.9	5.0	5.2	3.0	0.8	0.1	0.1	…
Memorandum items:										
Purchases	126.0	92.1	69.1	0.0	0.0	0.0	0.0	0.0	0.0	287.2
Fund credit outstanding (end period)	192.9	258.3	277.7	184.0	80.5	17.2	0.0	0.0	0.0	…
(percent of quota)	30.2	40.5	43.5	28.8	12.6	2.7	0.0	0.0	0.0	…
(percent of GDP)	0.4	0.6	0.6	0.4	0.1	0.0	0.0	0.0	0.0	…
(percent of total public debt)	1.0	1.3	1.4	0.9	0.4	0.1	0.0	0.0	0.0	…
(percent of external public debt)	1.3	1.7	1.8	1.1	0.5	0.1	0.0	0.0	0.0	…
(percent of external public debt service)	11.1	13.8	14.1	9.2	3.8	0.8	0.0	0.0	0.0	…
(percent of gross foreign reserves)	2.8	3.7	4.0	2.6	1.1	0.2	0.0	0.0	0.0	…

Sources: Fund staff estimates and projections.

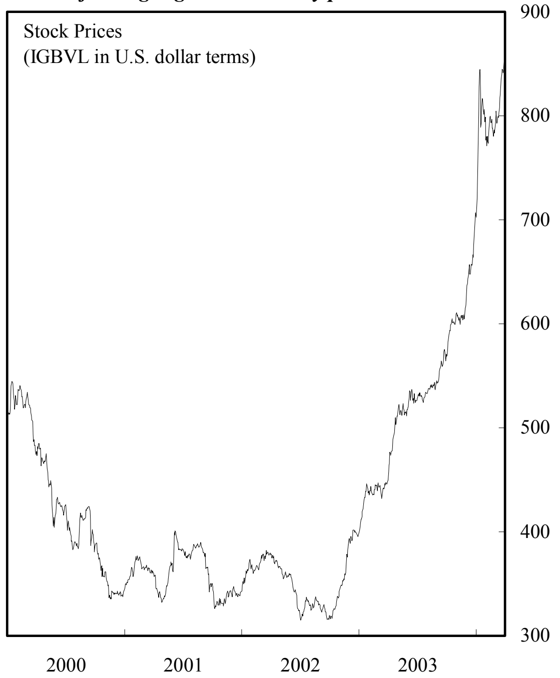
1/ Assuming all scheduled purchases are made. Repurchases assumed to be made under expectation schedule.
2/ Projections are based on current rates of charge, including burden-sharing charges where applicable, for purchases in the GRA, and on current interest rates for PRGF and Trust Fund. The current SDR interest rate is assumed for net use of SDRs.

Figure 1. Peru: Selected Economic and Labor Indicators, 2000–2004

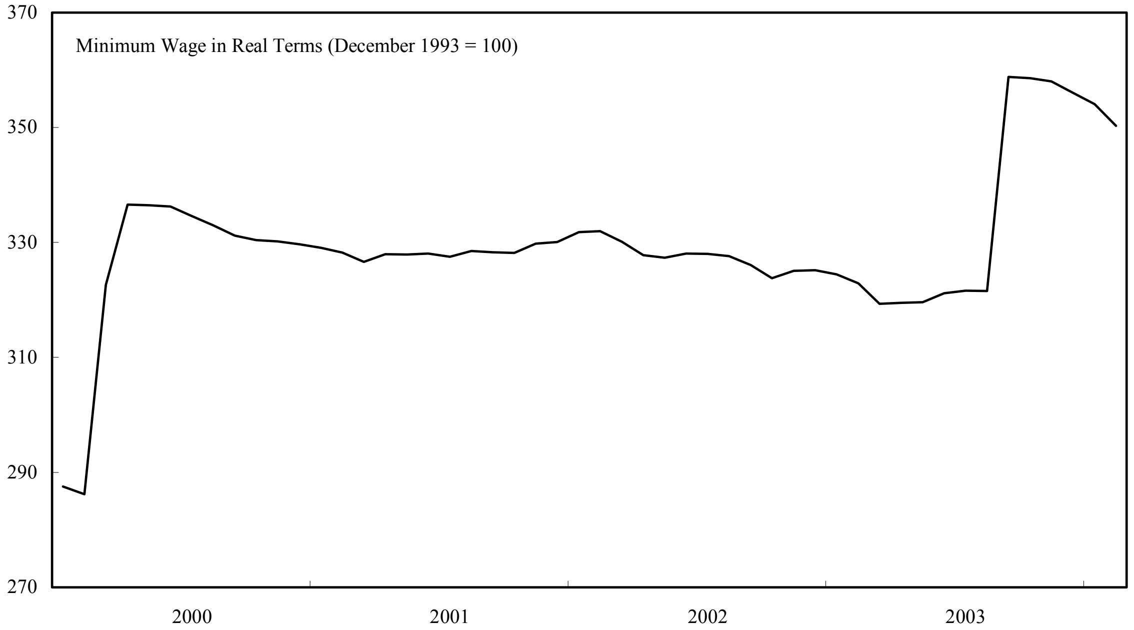
Domestic demand has been the engine of growth.



Stock prices in U.S. dollar terms recovered strongly in 2003 reflecting higher commodity prices.



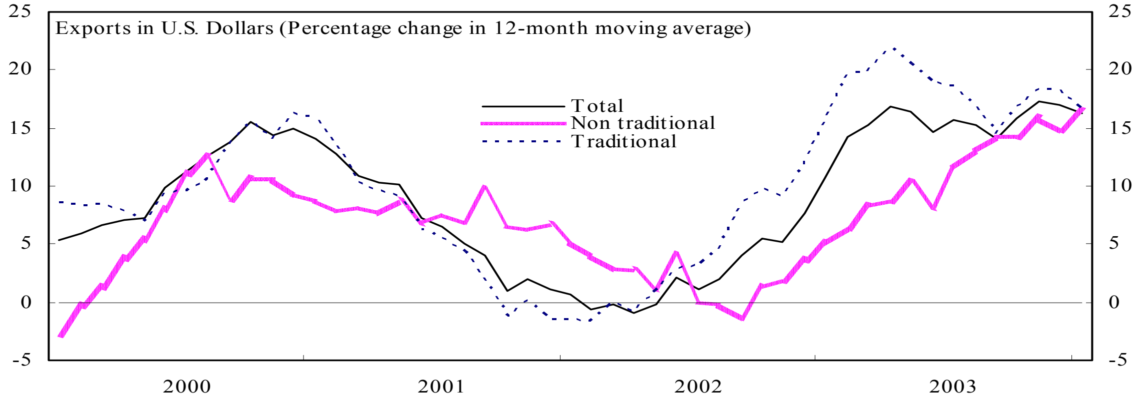
The minimum wage was adjusted in September 2003 for the first time since 2000.



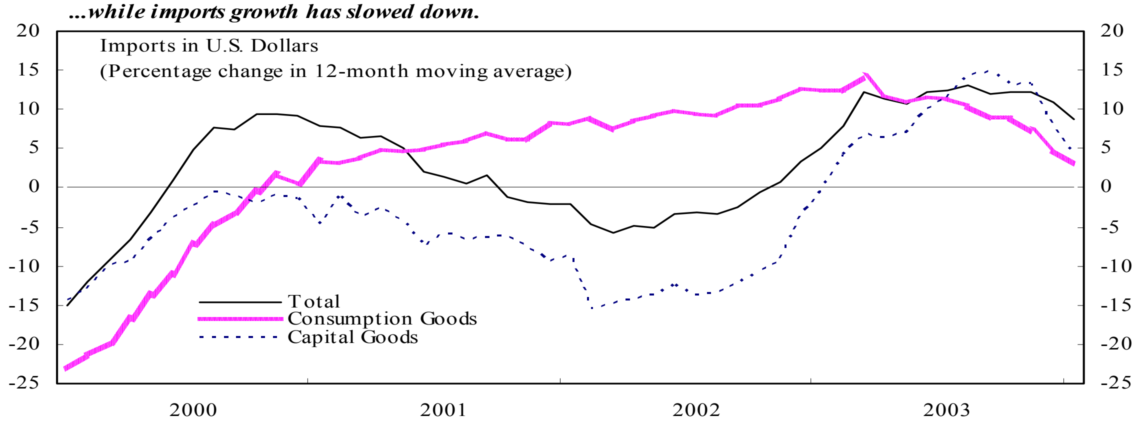
Sources: Central Reserve Bank of Peru; Yahoo Finance; and Ministry of Labor.

Figure 2. Peru: Trade Indicators, 2000–2004

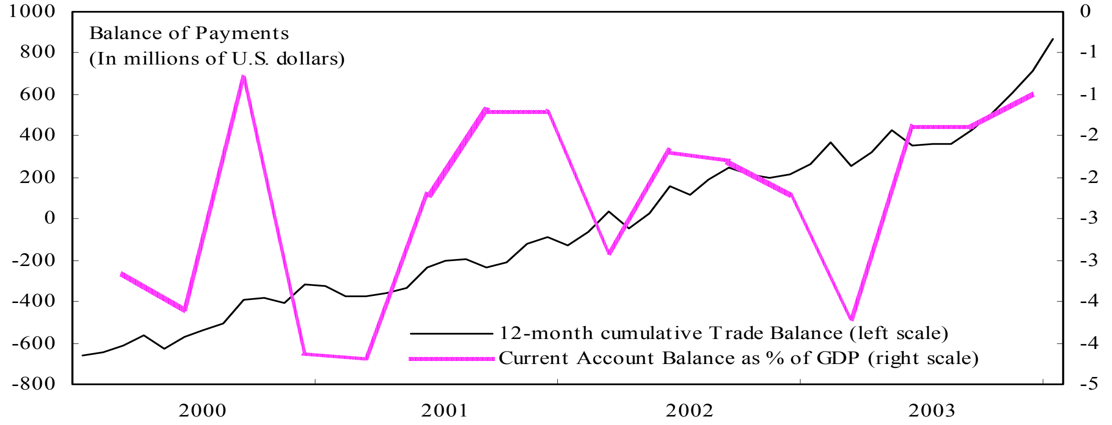
Exports have grown strongly in 2003, particularly traditional exports (minerals) and textiles ...



...while imports growth has slowed down.



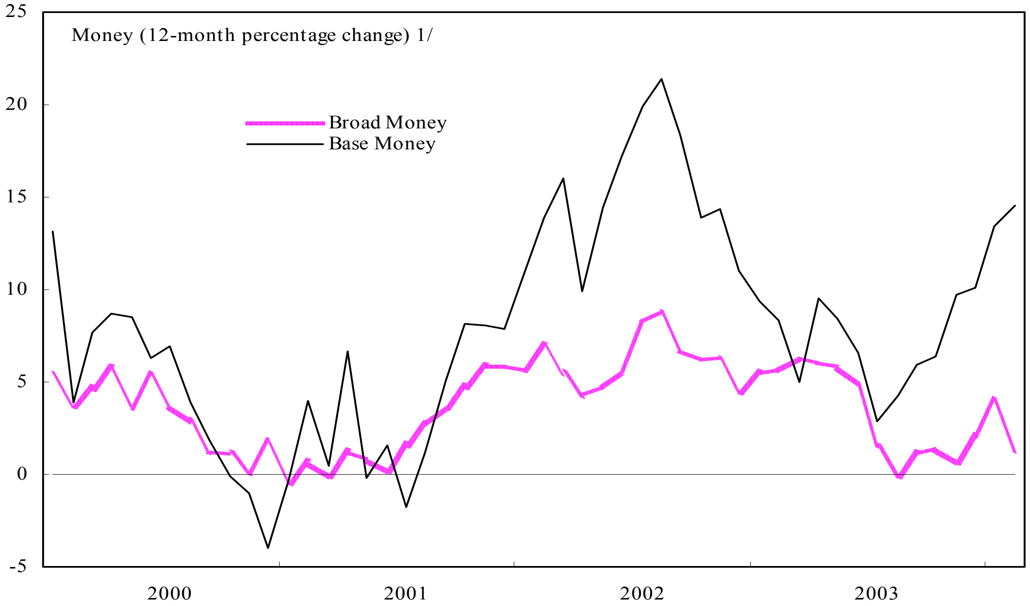
The current account deficit has remained stable, with a growing trade surplus offsetting higher investment-income payments.



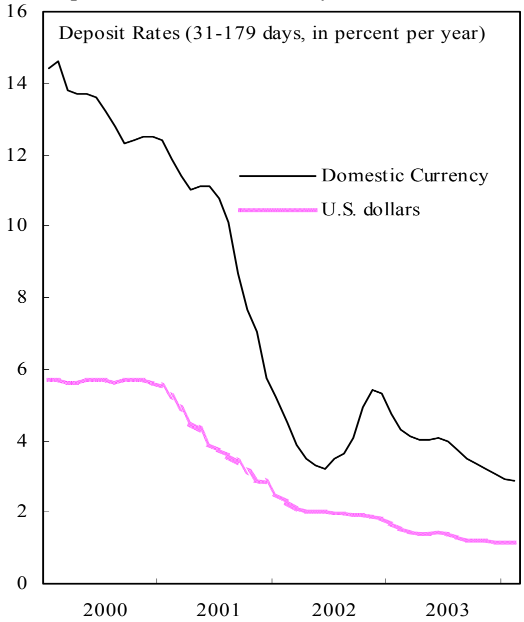
Source: Central Reserve Bank of Peru.

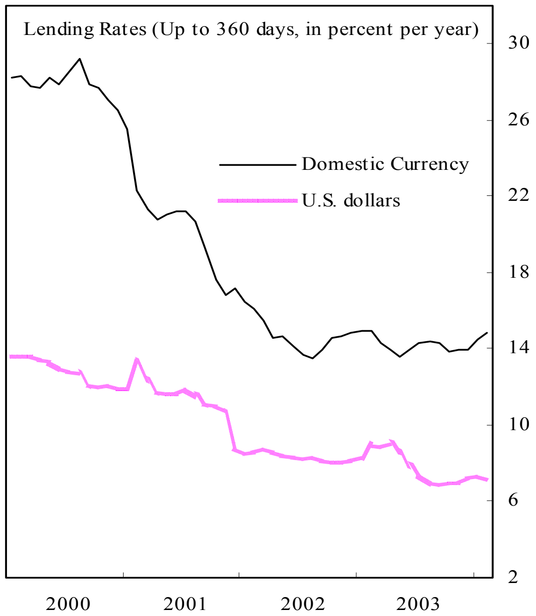
Figure 3. Peru: Monetary Indicators, 2000–2004

Monetary growth rates has picked up in recent months.



Deposit rates are at historically low levels... ***... as are lending rates.***



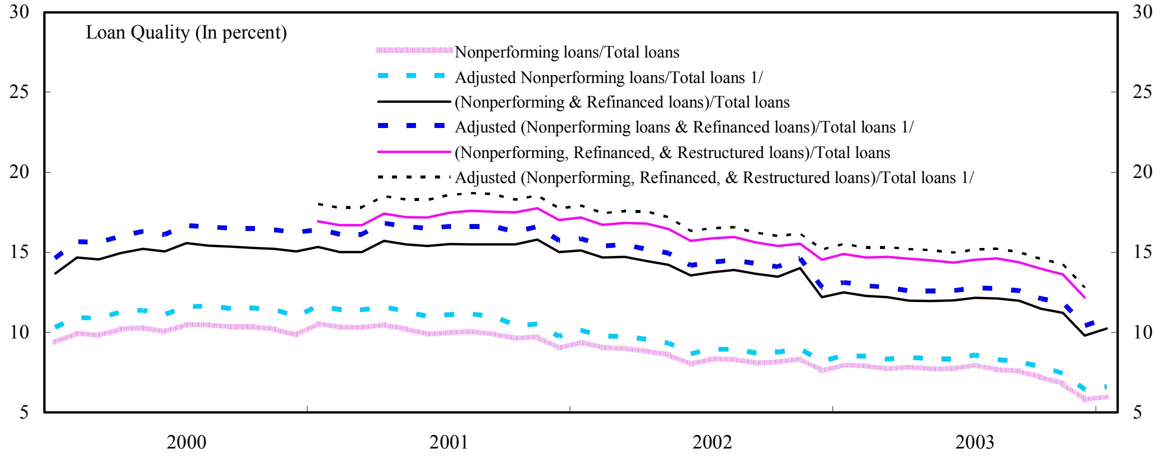


Sources: Central Reserve Bank of Peru; Superintendency of Banks; and Fund staff estimates.

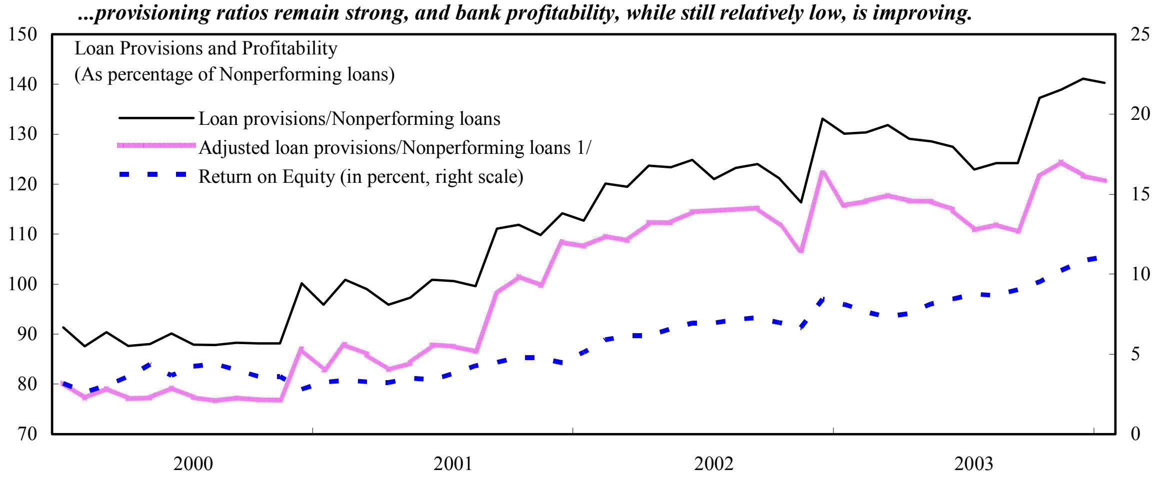
1/ U.S. dollar stocks are valued at market exchange rates.

Figure 4. Peru: Banking Indicators, 2000–2004

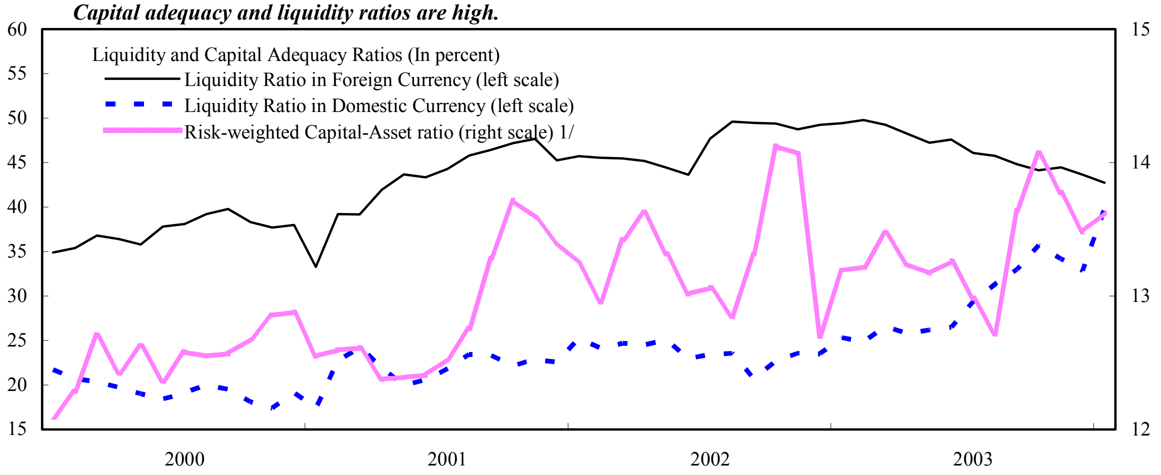
Average non-performing loan ratios continue to decline...



...provisioning ratios remain strong, and bank profitability, while still relatively low, is improving.



Capital adequacy and liquidity ratios are high.

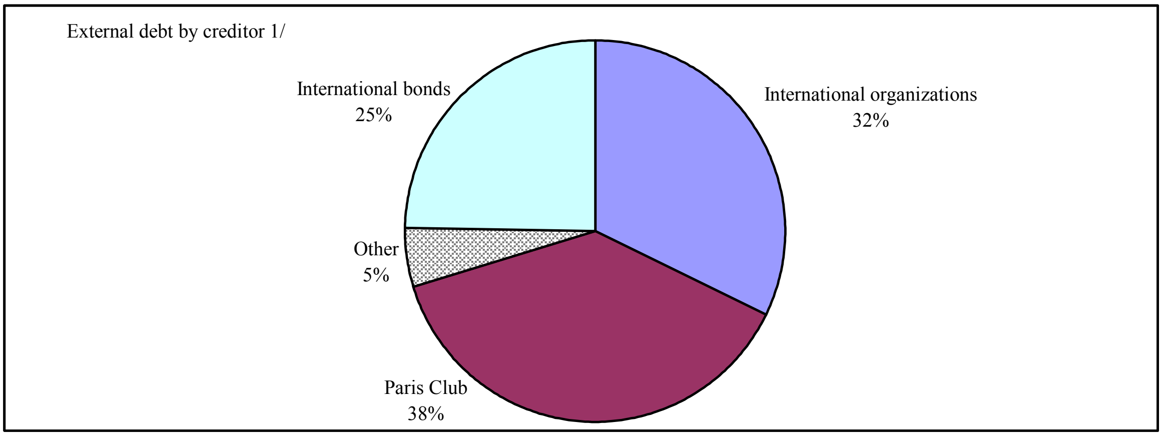


Source: Superintendency of Banks and Insurance.

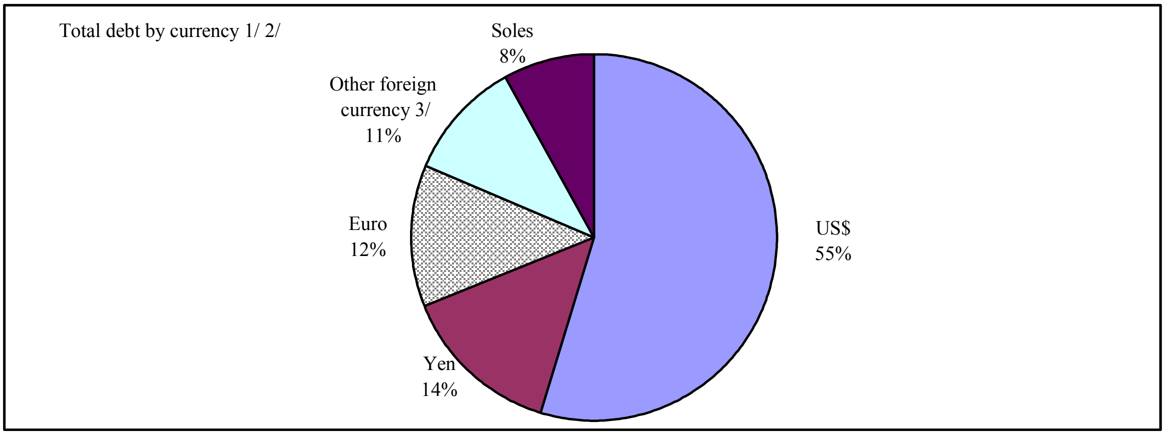
1/ Adjusted for the bond-for-loan swap programs from August 1999.

Figure 5. Peru: Composition of Public Debt, December 2003

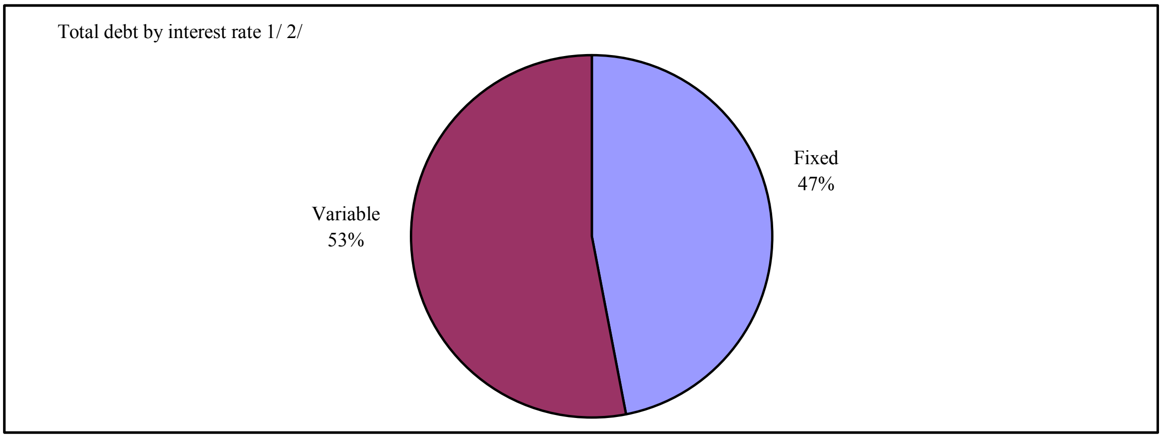
Three-fourths of the US$22.8 billion public external debt is owed to official creditors.



92 percent of the US$29.7 billion total public debt is denominated in foreign currency.



Slightly more than half of the public debt bears a variable interest rate.



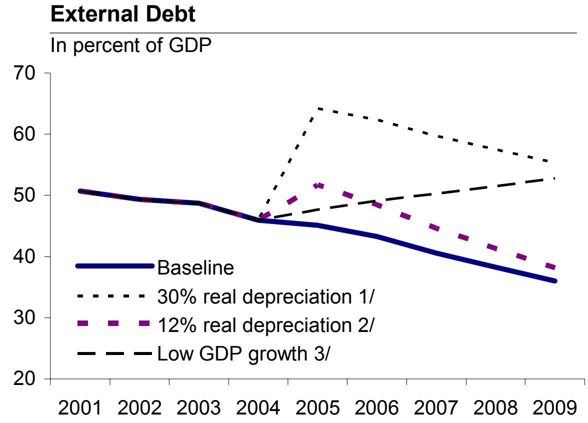
Source: Ministry of Economy and Finance.

1/ Millions of U.S. dollars.
2/ Domestic debt includes floating debt.
3/ Includes loans expressed as a currency basket, comprised mostly of Euro, Yen, and U.S. dollars.

Peru—Debt Sustainability Analysis[14]

External and public sector debt in the baseline projections is quite robust to alternative assumptions about underlying macroeconomic variables. Using ten-year historical averages of the key assumptions does not significantly alter the medium-term projection. Additional temporary negative shocks to key variables, such as interest rates and real GDP growth, would lead to some increase in the level of public and external debt, but the ratios would return to a declining trend once conditions normalize.

External and public debt is also resilient to real exchange rate shocks of magnitudes experienced by Peru in the recent past and to which there is a corresponding current account adjustment, but the debt dynamics appear vulnerable to a very large decline in the real exchange rate. A 12–percent permanent real depreciation that leads to a contraction in domestic demand and an improvement in the external current account would result initially in somewhat higher external and public debt-to-GDP ratios, but thereafter those ratios would decline rapidly. A sustained 30–percent real depreciation leads to a sharper initial increase in the debt ratios, with a more protracted period of higher ratios.



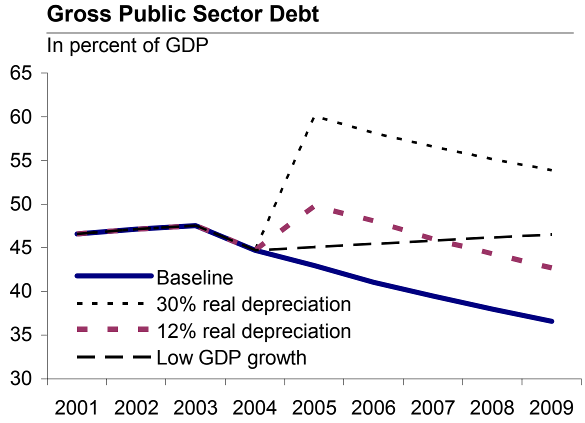


Chart Notes:
1/ Effect of a sustained 30 percent real depreciation of the Nuevo Sol, and no current account adjustment.
2/ Effect of a sustained 12 percent real depreciation of the Nuevo Sol, and endogenous current account adjustment.
3/ Effect of a reduction in the baseline growth path from 4 percent to 2 percent

The debt dynamics appear moderately vulnerable to a sustained reduction in demand for Peru's exports, and somewhat more so if the government tries to offset the economic slowdown by running higher fiscal deficits. A reduction in baseline growth from 4 percent to 2 percent, owing to an export shock, countered by increasing the fiscal deficit to 2 percent of GDP (the limit established under the country's fiscal responsibility law during recessionary periods), leads to moderately rising ratios of external and public sector-debt-to-GDP.[15]

[14] The DSA includes standard sensitivity tests around the baseline medium-term scenario. The methodology used is in line with that endorsed in the paper on Assessing Sustainability, dated May 28, 2002 (www.imf.org).

[15] External and public sector debt remains robust in the case of a hike in public investment of 1 percent of GDP, owing to PPPs, that result in a fiscal deficit of 2 percent of GDP over the medium term.

Table 1a. Peru: Standard External Debt Sustainability Framework, Baseline Scenario, 1999–2009
(In percent of GDP, unless otherwise indicated)

	Actual					Projections					
	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
External debt	55.6	52.7	50.7	49.3	48.7	**45.9**	**45.1**	**43.2**	**40.6**	**38.3**	**36.0**
Change in external debt	2.4	-2.9	-2.0	-1.4	-0.6	-2.8	-0.8	-1.9	-2.7	-2.3	-2.3
Identified external debt-creating flows (4+8+11)	5.4	0.5	0.2	-3.7	-2.0	-3.3	-1.1	-2.2	-2.6	-2.4	-2.4
Current account deficit, excluding interest payments	-0.5	-0.5	-0.9	-0.3	-0.4	-1.6	-1.7	-2.0	-1.8	-1.9	-1.9
Deficit in balance of goods and services	2.5	2.2	2.1	1.3	0.5	-1.6	-1.5	-1.6	-1.8	-1.8	-1.8
Exports	14.9	16.1	15.9	16.3	17.3	19.1	19.0	19.4	19.2	19.4	19.4
Imports	17.4	18.3	17.9	17.6	17.7	17.6	17.5	17.7	17.5	17.5	17.6
Net non-debt creating capital inflows (negative)	-2.9	-0.9	-1.4	-3.4	-0.2	-0.1	0.4	-0.3	-0.8	-0.7	-0.8
Net foreign direct investment, equity	3.5	1.5	2.0	4.2	2.2	1.7	1.7	1.8	1.0	1.0	1.1
Net portfolio investment,equity	-0.6	-0.6	-0.6	-0.9	-2.0	-1.5	-2.2	-1.5	-0.3	-0.4	-0.3
Automatic debt dynamics 1/	8.8	1.9	2.5	-0.1	-1.5	-1.6	0.2	0.1	0.0	0.2	0.3
Contribution from nominal interest rate	3.4	3.4	3.1	2.4	2.2	2.3	2.5	2.6	2.6	2.5	2.5
Contribution from real GDP growth	-0.6	-1.5	-0.1	-2.3	-1.8	-1.8	-2.0	-1.9	-1.6	-1.5	-1.4
Contribution from price and exchange rate changes 2/	6.0	0.0	-0.4	-0.2	-1.9	-2.1	-0.4	-0.6	-0.9	-0.8	-0.8
Residual, incl. change in gross foreign assets (2-3)	-2.9	-3.3	-2.2	2.4	1.4	0.6	0.3	0.3	-0.1	0.1	0.1
External debt-to-exports ratio (in percent)	371.9	327.1	319.3	302.9	281.9	239.9	237.7	223.0	210.9	197.7	185.4
Gross external financing need (in billions of U.S. dollars) 3/	9.5	8.3	6.7	7.2	5.6	5.1	5.2	5.1	5.6	5.5	5.5
In percent of GDP	18.3	15.6	12.5	12.8	9.2	7.6	7.4	6.9	7.2	6.6	6.2
Key Macroeconomic and External Assumptions											
Real GDP growth (in percent)	0.9	2.8	0.3	4.9	4.0	4.0	4.5	4.5	4.0	4.0	4.0
Exchange rate appreciation (U.S. dollar value of local currency, change in percent)	-13.5	-3.2	-0.4	-0.2	1.1	-0.5	-1.0	-1.1	-0.4	-0.4	-0.4
GDP deflator in U.S. dollars (change in percent)	-10.1	0.1	0.8	0.3	4.0	4.5	0.9	1.4	2.1	2.1	2.2
Nominal external interest rate (in percent) 4/	5.8	6.3	5.9	5.0	4.8	5.1	5.8	6.2	6.3	6.6	7.0
Growth of exports (U.S. dollar terms, in percent)	2.4	10.9	-0.4	7.9	14.7	20.4	4.5	8.3	5.4	6.9	6.5
Growth of imports (U.S. dollar terms, in percent)	-15.4	7.7	-0.9	3.3	9.0	7.5	5.1	7.5	4.6	6.5	6.6
					Stress Tests for External Debt Ratio						
1. Real GDP growth, nominal interest rate, dollar deflator, non-interest current account, and non-debt inflows are at historical average in 2005-2009					**48.7**	**45.9**	**43.9**	**42.0**	**39.6**	**37.5**	**35.4**
2. Nominal interest rate is at historical average plus two standard deviations in 2005 and 2006					**48.7**	**45.9**	**45.9**	**44.7**	**42.0**	**39.7**	**37.5**
3. Real GDP growth is at historical average minus two standard deviations in 2005 and 2006					**48.7**	**45.9**	**49.2**	**51.7**	**49.0**	**46.8**	**44.5**
4. Non-interest current account is at historical average minus two standard deviations in 2005 and 2006					**48.7**	**45.9**	**52.1**	**57.4**	**54.8**	**52.5**	**50.4**
5. Combination of 2-4 using one standard deviation shocks					**48.7**	**45.9**	**52.5**	**58.5**	**55.8**	**53.6**	**51.4**
6. One time 30 percent nominal depreciation in 2005					**48.7**	**45.9**	**64.2**	**62.4**	**59.7**	**57.5**	**55.3**
7. One time 15 percent nominal depreciation in 2005					**48.7**	**45.9**	**52.7**	**50.9**	**48.2**	**45.9**	**43.7**

Historical Statistics for Key Variables (past 10 years)	Historical Average	Standard Deviation
Current account deficit, excluding interest payments	1.3	2.0
Net non-debt creating capital inflows	3.4	2.6
Nominal external interest rate (in percent)	5.9	0.9
Real GDP growth (in percent)	4.3	4.1

1/ Derived as [r - g - ρ(1+g) + εα(1+r)]/(1+g+ρ+gρ) times previous period debt stock, with r = nominal effective interest rate on external debt; ρ = change in domestic GDP deflator in US$ terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.
2/ The contribution from price and exchange rate changes is defined as [-ρ(1+g) + εα(1+r)]/(1+g+ρ+gρ) times previous period debt stock. ρ increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator)
3/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.
4/ Interest rate assumption for 2004-2008 reflects current market information.

Table 1b. Peru: Standard Public Sector Debt Sustainability Framework, Baseline Scenario, 1999-2009
(In percent of GDP, unless otherwise indicated)

	Actual					Projections					
	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
I. Baseline Medium-Term Projections											
1 Public sector debt 1/	48.0	45.9	46.6	47.1	47.6	**44.7**	**43.0**	**41.1**	**39.5**	**38.0**	**36.6**
o/w foreign-currency denominated	43.2	41.3	41.9	41.5	41.8	**37.6**	**36.1**	**34.5**	**31.6**	**30.4**	**29.3**
2 Change in public sector debt	5.9	-2.1	0.7	0.6	0.4	-2.8	-1.7	-1.9	-1.6	-1.5	-1.4
3 Identified debt-creating flows (4+7+12)	4.6	-0.2	0.3	-0.8	-1.1	-2.7	-1.4	-1.5	-1.5	-1.4	-1.3
4 Primary deficit	0.7	0.8	0.0	0.0	-0.4	-0.8	-1.4	-1.5	-1.4	-1.5	-1.5
5 Revenue and grants 2/	18.8	18.0	18.1	17.7	18.0	18.0	18.0	17.9	17.6	17.6	17.6
6 Primary (noninterest) expenditure 2/	19.5	18.7	18.2	17.7	17.6	17.2	16.6	16.4	16.2	16.1	16.1
7 Automatic debt dynamics 3/	4.6	-0.2	0.9	-0.1	-0.6	-1.7	0.1	0.0	0.0	0.2	0.2
8 Contribution from interest rate/growth differential 4/	0.4	-0.6	1.9	-0.2	-0.9	-1.9	-0.3	-0.4	-0.1	0.1	0.1
9 *Of which:* contribution from real interest rate	0.7	0.6	2.0	1.9	0.8	-0.2	1.6	1.4	1.4	1.6	1.5
10 *Of which:* contribution from real GDP growth	-0.4	-1.2	-0.1	-2.1	-1.7	-1.7	-1.9	-1.8	-1.6	-1.5	-1.4
11 Contribution from exchange rate depreciation 5/	4.3	0.4	-1.0	0.1	0.3	0.2	0.4	0.4	0.1	0.1	0.1
12 Other identified debt-creating flows	-0.7	-0.8	-0.6	-0.7	-0.1	-0.2	-0.1	0.0	0.0	0.0	0.0
13 Privatization receipts (negative)	-0.7	-0.8	-0.6	-0.7	-0.1	-0.2	-0.1	0.0	0.0	0.0	0.0
14 Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
15 Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
16 Residual, including asset changes (2-3)	1.3	-1.9	0.4	1.4	1.5	-0.2	-0.4	-0.4	-0.1	-0.1	-0.1
Public sector debt in percent of revenues 1/	255.3	255.3	256.7	267.0	264.9	249.0	238.9	229.4	223.6	215.4	208.4
Overall deficit	-3.0	-3.2	-2.3	-2.2	-1.7	-1.4	-1.0	-1.0	-1.0	-1.0	-1.0
Interest payment	2.3	2.4	2.2	2.2	2.1	2.2	2.4	2.5	2.5	2.6	2.5
Gross financing 6/	6.1	6.2	4.8	6.2	4.5	4.4	3.7	3.6	3.5	4.4	4.2
in billions of U.S. dollars	3.2	3.3	2.6	3.5	2.7	2.9	2.6	2.7	2.7	3.7	3.7
Additional Macroeconomic and Fiscal Assumptions											
Nominal GDP (local currency)	174.7	186.8	188.2	198.4	211.8	231.6	246.6	264.2	282.0	301.1	321.2
Average nominal interest rate on public debt (in percent) 7/ 8/ 9/	5.8	5.4	4.9	4.9	4.7	5.0	5.8	6.2	6.5	7.0	7.0
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	1.9	1.4	4.4	4.3	2.0	-0.1	3.9	3.7	3.8	4.4	4.4
Interest rate on new market external financing (in percent) 9/	...	...	...	...	11.0	11.0	10.0	10.0	10.0	10.0	11.0
Gross market external financing in percent of total external financing	...	...	...	...	38.9	38.9	38.9	38.9	38.9	38.9	38.9
Exchange rate (LC per US dollar)	3.5	3.5	3.4	3.5	3.5	3.5	3.5	3.6	3.6	3.6	3.6
Nominal appreciation (increase in US dollar value of local currency, in percent) 10/	-10.0	-1.0	2.4	-0.3	-0.7	-0.5	-1.0	-1.1	-0.4	-0.4	-0.4
Inflation rate (GDP deflator, in percent)	3.9	4.0	0.5	0.6	2.7	5.2	1.9	2.5	2.6	2.6	2.6
Growth of real primary spending (deflated by GDP deflator, in percent)	5.5	-1.1	-2.8	2.0	3.5	1.4	1.0	3.2	3.0	3.3	4.1
II. Stress Tests											
1. Real GDP growth, real interest rate, and primary balance are at historical averages in 2005-2009					**47.6**	**44.7**	**42.1**	**39.6**	**37.2**	**34.8**	**32.6**
2. Real interest rate is at historical average plus two standard deviations in 2005 and 2006					**47.6**	**44.7**	**44.5**	**44.1**	**42.5**	**41.0**	**39.7**
3. Real GDP growth is at historical average minus two standard deviations in 2005 and 2006					**47.6**	**44.7**	**46.8**	**48.8**	**46.9**	**45.2**	**43.5**
4. Primary balance is at historical average minus two standard deviations in 2005 and 2006					**47.6**	**44.7**	**45.8**	**46.7**	**45.2**	**43.7**	**42.3**
5. Combination of 2-4 using one standard deviation shocks					**47.6**	**44.7**	**46.6**	**48.7**	**45.5**	**42.5**	**39.6**
6. 30 percent real depreciation in 2005 11/					**47.6**	**44.7**	**60.1**	**58.1**	**56.6**	**55.2**	**53.9**
6a. 15 percent real depreciation in 2005 11/					**47.6**	**44.7**	**50.2**	**48.3**	**46.7**	**45.2**	**43.9**
7. 10 percent of GDP increase in other debt-creating flows in 2004					**47.6**	**44.7**	**53.0**	**51.1**	**49.5**	**48.0**	**46.7**
8. Impact on **debt-to-GDP ratio** if revenue-to-GDP ratio is at historical average minus two standard deviations in 2005-06					**47.6**	**44.7**	**43.9**	**42.8**	**41.2**	**39.7**	**38.3**
8a. Impact on **debt-to-revenue ratio** if revenue-to-GDP ratio is at historical average minus two standard deviations in 2005-06					**264.9**	**249.0**	**256.8**	**250.3**	**233.4**	**225.2**	**218.2**

Historical Statistics for Key Variables (1994-2003)	Historical Average	Standard Deviation
Primary deficit	-0.5	1.0
Real GDP growth (in percent)	4.3	4.1
Nominal interest rate (in percent) 7/	5.6	1.1
Real interest rate (in percent) 12/	-0.1	3.8
Inflation rate (GDP deflator, in percent)	7.5	7.7
Revenue to GDP ratio	18.8	0.9

1/ Gross debt of the public sector including debt of public enterprises and the central bank.
2/ Net of transfers among non-financial public institutions.
3/ Derived as $[(r - \pi(1+g) - g + \alpha\varepsilon(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; α = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by the increase in local currency value of U.S. dollar).
4/ The real interest rate contribution is derived from the denominator in footnote 3/.
5/ The exchange rate contribution is derived from the numerator in footnote 3/.
6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.
7/ Derived as nominal interest expenditure divided by previous period debt stock.
8/ Assumption on domestic interest rate for 2004-2009 reflects current market information in the context of the inflation-targeting framework.
9/ Assumption on the external interest rate for 2004-2009 reflects current market information.
10/ Based on end of period exchange rate.
11/ Real depreciation is defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).
12/ Calculated for period 1995-2003 to exclude the effect of recovery from hyperinflation during early 1990s.

Table 2. Peru: Endogenized External and Public Sector Debt Sustainability Framework, Real Exchange Rate Scenario, 1999-2009
(In percent of GDP, unless otherwise indicated)

	Actual					Projections					
	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
External debt	55.6	52.7	50.7	49.3	48.7	**45.9**	**51.7**	**48.4**	**44.6**	**41.3**	**38.1**
External debt-to-exports ratio (in percent)	371.9	327.1	319.3	302.9	281.9	239.9	232.7	223.2	204.2	189.2	173.9
External gross financing need (in billions of U.S. dollars) 1/	9.5	7.8	6.7	7.2	5.6	5.1	4.7	4.8	5.2	5.1	5.1
in percent of GDP	18.3	14.7	12.5	12.8	9.2	7.6	7.8	7.5	7.7	7.1	6.7
Public sector debt 2/	48.0	45.9	46.6	47.1	47.6	**44.7**	**49.8**	**48.1**	**46.0**	**44.3**	**42.7**
o/w foreign-currency denominated	43.2	41.3	41.9	41.5	41.8	**37.6**	**41.8**	**40.4**	**36.8**	**35.4**	**34.2**
Public sector debt in percent of revenues	255.3	255.3	256.7	267.0	264.9	249.0	266.3	258.9	252.4	243.5	235.7
Overall deficit	-3.0	-3.2	-2.3	-2.2	-1.7	-1.4	-0.9	-1.2	-1.1	-1.1	-1.1
Interest payment	2.3	2.4	2.2	2.2	2.1	2.2	2.8	3.2	2.9	3.0	2.9
Public sector gross financing 3/	6.1	6.2	4.8	6.2	4.5	4.4	3.9	4.0	3.5	4.5	4.2
in billions of U.S. dollars	3.2	3.3	2.6	3.5	2.7	2.9	2.4	2.5	2.4	3.2	3.2

1/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.
2/ Gross debt of the public sector including debt of public enterprises and the central bank.
3/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.

Table 3. Peru: Endogenized External and Public Sector Debt Sustainability Framework, Low Growth Scenario, 1999-2009

(In percent of GDP, unless otherwise indicated)

	Actual					Projections					
	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
External debt	55.6	52.7	50.7	49.3	48.7	**45.9**	**47.7**	**49.1**	**50.3**	**51.5**	**52.8**
External debt-to-exports ratio (in percent)	371.9	327.1	319.3	302.9	281.9	239.9	264.2	276.2	286.7	297.8	309.5
Gross external financing need (in billions of U.S. dollars) 1/	9.5	7.8	6.7	7.2	5.6	5.1	5.9	6.3	7.1	7.1	7.4
in percent of GDP	18.3	14.7	12.5	12.8	9.2	7.6	8.6	8.9	9.6	9.4	9.4
Public sector debt 2/	48.0	45.9	46.6	47.1	47.6	**44.7**	**45.1**	**45.4**	**45.8**	**46.2**	**46.5**
o/w foreign-currency denominated	43.2	41.3	41.9	41.5	41.8	**37.6**	**37.9**	**38.2**	**36.7**	**36.9**	**37.2**
Public sector debt in percent of revenues	255.3	255.3	256.7	267.0	264.9	249.0	278.8	286.8	294.5	303.1	305.0
Overall deficit	-3.0	-3.2	-2.3	-2.2	-1.7	-1.4	-2.0	-2.0	-2.0	-2.0	-2.0
Interest payment	2.3	2.4	2.2	2.2	2.1	2.2	2.5	2.7	2.8	3.1	3.1
Public sector gross financing 3/	6.1	6.2	4.8	6.2	4.5	4.4	4.0	4.1	4.2	5.5	5.5
in billions of U.S. dollars	3.2	3.3	2.6	3.5	2.7	2.9	2.8	2.9	3.1	4.2	4.3

1/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.
2/ Gross debt of the public sector including debt of public enterprises and the central bank.
3/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.

Peru: Fund Relations
(As of March 31, 2004)

I. Membership Status: Joined 12/31/1945; accepted Article VIII obligations on February 15, 1961.

II. General Resources Account	**SDR Million**	**Percent Quota**
Quota	638.40	100.00
Fund holdings of currency	718.68	112.58

III. SDR Department	**SDR Million**	**Percent Allocation**
Net cumulative allocation	91.32	100.00
Holdings	0.05	0.05

IV. Outstanding Purchases and Loans	**SDR Million**	**Percent Quota**
Extended arrangements	80.25	12.57

V. Financial Arrangements

Type of Arrangement	**Approval Date**	**Expiration Date**	**Amount Approved (SDR Million)**	**Amount Drawn (SDR Million)**
Stand-By	2/01/02	2/29/04	255.00	0.00
Stand-By	3/12/01	1/31/02	128.00	0.00
EFF	6/24/99	2/08/01	383.00	0.00

VI. Projected Obligations to the Fund (SDR Million; based on existing use of resources and present holdings of SDRs):

	Overdue	**Forthcoming**				
	12/31/03	**2004**	**2005**	**2006**	**2007**	**2008**
Principal	0	13.38	26.75	26.75	13.38	0.00
Charges/interest	0	2.36	2.64	2.06	1.53	1.45
Total	0	15.73	29.39	28.81	14.91	1.45

VII. Safeguard Assessments

Under the Fund's safeguards assessment policy, the Central Reserve Bank of Peru is subject to a full safeguards assessment with respect to the Stand-By Arrangement which expired on February 29, 2004.

A safeguards assessment was completed on July 26, 2001. The assessment identified certain weaknesses (most notably with the central bank's implementation of International Accounting Standards) and provided recommendations to address them. The Central Reserve Bank of Peru has proceeded to implement all of the recommendations.

VIII. Exchange Arrangements

Peru maintains a unified, managed floating exchange rate. On March 31, 2004, the average of interbank buying and selling rates was 3.48 *Nuevo Sol* per U.S. dollar. The central government maintains external payments arrears to unguaranteed suppliers, some of whom are in discussions with the government,

while the rest have not been located. Peru has maintained a clearing arrangement with Malaysia since 1991.

IX. Last Article IV Consultation

The 2003 Article IV consultation was concluded on February 23, 2004, (Country Report No. 04/155).

X. FSAP and ROSCs

Several joint Fund-Bank missions visited Lima in the period September 2000–January 2001 to conduct an FSAP for Peru. The corresponding FSSA report dated March 8, 2001, was discussed by the Executive Board on March 12, 2001. In October 2002, an FAD mission conducted a Fiscal ROSC for Peru, while an STA mission conducted a Data ROSC for Peru in February 2003.

XI. Technical Assistance

Department	Date	Purpose
FAD	June 2000, September 2002, September 2003	Tax policy and administration
	November 1999	Fiscal rules
MFD	March 2004	Central Bank Organization
	February 2003, April, December 2002	Inflation Targeting
	October 2002	Foreign exchange operations
	August 2002	Accounting and organizational issues
	May 2002	Inflation targeting
	March 2002	Monetary operations and government securities market
STA	January 1998 and October 1999	National account statistics, new base year for the national account series
TRE	March 1999	Central bank accounting.

XII. Resident Representative

Mr. Jorge Guzmán has been the Fund Senior Resident Representative in Peru since August 2003.

Peru: World Bank Relations

Bank Group strategy

The World Bank Group Country Assistance Strategy (CAS), discussed by the IBRD Board on September 17, 2002, supports the implementation of the government's poverty reduction strategy with programs addressing fiscal, national competitiveness, and social-sector needs. In November 2003, following a comprehensive review of the country's performance, the Bank decided to move Peru to a CAS high-case lending scenario entailing a total envelope of around US$300–400 million a year over FY04–06. Triggers met for the high case are related to the tax ratio and satisfactory progress in the implementation of key reforms in public sector management, social sectors, decentralization, and competitiveness. New lending includes additional quick-disbursing programmatic loans and investment projects for an additional US$200 million a year.

In 2003, following the additional priorities outlined in the CAS, the Bank approved four operations for US$365 million for Peru (See Appendix IV, Country Report 04/155). As of March 2004, the Bank has approved a $12 million loan for Peru to improve the delivery of justice services, strengthen justice sector institutions, and enhance public confidence in the justice system. Two technical assistance loans to support the programmatic loans are currently under preparation.

Bank-Fund collaboration in specific areas

- *Tax Reform and Fiscal Decentralization*. Fund staff has taken the lead in assisting in the design of tax reform. Jointly with the World Bank and IDB, staff has worked on drafting laws and regulations for fiscal decentralization. The World Bank has also focused on the design and implementation of decentralization of the social sectors and pro-poor spending policies.
- *Financial Sector.* A joint FSAP was completed in May 2001. Follow up technical assistance to implement FSAP recommendations has been given by both institutions.
- *Public expenditure review (PER).* In a joint effort with the IDB, and close collaboration with the IMF, the Bank completed in June 2002 a comprehensive diagnosis of, and made policy recommendations for, Peru's public expenditure management.
- *Fiscal reforms.* In March 2002, in Lima, the Bank and the Fund supported jointly an international seminar (organized by the Ministry of Economy and Finance) on proposals for revising the law on fiscal prudence and transparency.
- *CAS follow-up and preparation of the Programmatic Loans* (Social Reform Loans I, II and III, and Decentralization and Competitiveness Loan I). The World Bank and the Fund have engaged in an interactive and continuous dialogue on CAS implementation and preparation of the subsequent programmatic loans. Dialogue has concentrated on the macroeconomic background, setting of triggers, overall loan conditionality, and risks and estimation of the fiscal implications of Bank operations.

Statement of World bank Loans
(As of March 31, 2004)

Loan Number	Year approved	Borrower	Purpose	In millions of U.S. dollars Total (Net of Cancellation)	Undisbursed
One hundred ten (115) loans fully disbursed				4,507.6	
Partially disbursed or undisbursed loans:					
40760	1996	Republic of Peru	Irrigation Rehabilitation	85.0	6.0
41300	1997	Republic of Peru	Sierra Natural Resources Management	51.0	2.8
43840	1998	Republic of Peru	Urban Property Rights	38.0	3.0
45190	1999	Republic of Peru	Agricultural Research and Extension	9.6	2.0
45270	1999	Republic of Peru	Health Reform Program	80.0	17.8
45360	2000	Republic of Peru	Indigenous People Development	5.0	3.9
46140	2001	Republic of Peru	Second Rural Roads Rehabilitation and Maintenance	50.0	27.7
71420	2002	Republic of Peru	Rural Water and Sanitation	50.0	49.1
71760	2003	Republic of Peru	Rural Education Project	52.5	52.5
71770	2003	Republic of Peru	Trade Facility and Productivity Improvement TA	20.0	20.0
72090	2003	Republic of Peru	Lima Transport Project	45.0	45.0
71600	2003	Republic of Peru	Lima Water Rehabilitation Additional Financing	20.0	20.0
72190	2004	Republic of Peru	Justice Services Improvement	12.0	12.0
Total disbursed:				4,710.9	
of which: amount repaid				1,865.5	
Total outstanding [1]				2,744.9	
Total undisbursed					261.8

1/ Includes exchange rate adjustments and loans sold to third parties.

Statement of IFC Investments
(As of March, 2004)
In millions of U.S. dollars

	Loans	Equity	Quasi	Participation Loans	Total
Total commitments held by IFC	281.6	28.1	30.0	56.6	396.4
Total disbursed	184.6	28.1	30.0	56.6	299.3

Source: World Bank.

Prepared by World Bank staff. Questions may be addressed to Ms. Rossana Polastri, Country Economist; or Mr. Oscar Avalle, Senior Operations Officer.

Peru—Relations with the Inter-American Development Bank

Country Strategy 2002–2006

The key objectives for the 2002–2006 strategy for Peru are poverty reduction and equity promotion, within the context of high economic growth, which is needed to make these goals sustainable. Toward this end the Bank will support the government's efforts to: (i) raise the economy's productivity and competitiveness, by removing institutional obstacles to increased productivity and investment and making structural investments in human capital; (ii) improve the efficiency of social policy while implementing measures to mitigate poverty and protect vulnerable groups; and (iii) create a modern, decentralized and efficient state.

Lending

As of February 29, 2004 the country's portfolio consists of 24 loans for a total amount of US$1,588 million. These resources are distributed among 22 investment loans (US$988 million) and two policy-based loan (US$600 million). The lending program for 2004 foresees the approval of eight loans for US$435 million. One of then is already approved.

In addition, the country portfolio with Peru includes 25 non-reimbursable technical cooperation grants (US$8.1 million) and five small projects (US$2.2 million). Through the Multilateral Investment Fund (MIF), which finances private sector investment projects, Peru has received 31 non-reimbursable technical cooperation grants (US$14 million).

IDB Loans By Sector as of February 29, 2004
(In millions of U.S. dollars)

	Commitments	Disbursements	Percent Disbursed
Agriculture	68.9	42.2	61.2
Education	184.6	106.9	57.9
Social investment	327.6	190.4	58.1
Public sector management	669.0	414.8	62.0
Environment	5.0	0.4	8.0
Health	28.0	5.2	18.7
Transportation	245.0	105.1	42.9
Urban development	60.0	0.0	0.0
Total	**1,588.1**	**865.1**	**54.5**

Peru—Statistical Issues

Peru is in observance of the Special Data Dissemination Standard (SDDS) and meets the specifications for coverage, periodicity, and timeliness of the data categories and the dissemination of the advance release calendars, and the metadata have been posted on the Fund's Dissemination Standards Bulletin Board.

I. Real Sector

In June 2000, the authorities published a revised GDP series using 1994 as the base year. However, since 1994, the statistical techniques have been largely based on extrapolation. Intermediate consumption is usually compiled as a fixed ratio of output, and the single indicator method is used to estimate GDP at constant prices. With the exception of mining, electricity, and financial and governmental services, the availability of source data is limited due to resource constraints to visit establishments. Response rates for some surveys are low owing to a collection method based on voluntary response to announcements in the press. In addition, the lack of an adequate business register limits the assessment of how representative are the samples. Also, the lack of detailed tables for supply and use hampers the reconciliation of discrepancies in the data. As a result, changes in inventories are mainly determined as a residual. Even though the quarterly accounts have benefited from some improvements in the timeliness of monthly production indices, their coverage is very limited. In order to improve the estimates, the National Statistics Office (INEI) recently announced its intention to produce a new GDP series using 2001 as the base year, which would become available in the near future. In the meantime, INEI will carry on with the publication of base-year 1994 GDP data.

The weight structure for the CPI is derived from a 1993–94 household expenditure survey. Except for weights, source data are timely and consistent with the technical requirements for producing the index. The coverage of owner-occupied housing, however, was eliminated from the Metropolitan Lima index through the exclusion of imputed rent, a deviation from international practices. Imputed rent is included in the indices of the other 24 cities in the CPI. Thus, the national index is a weighted average of indices that have different coverage. The weights for the WPI are also outdated. INEI derived the weights from the 1994 input-output table and other reports and publications of relevant ministries. The WPI establishment sample could be improved. Although annual and monthly economic surveys are available, there has not been a comprehensive economic census since 1994. An updated business register does not exist, and INEI has had difficulty in obtaining measure-of-size data for a new establishment sample. With the exception of the outdated weights and small sample, the WPI statistical techniques follow generally accepted international standards.

The authorities monitor labor market developments through four indicators: open unemployment, underemployment, employment, and remunerations. The quality of these indicators has improved over the last two years. However, wage data comes with a relatively long delay; the nationwide unemployment and underemployment situation is surveyed only once a year; and labor productivity data is only published at the time of adjustments to electricity and telecommunications tariffs.

II. Fiscal Sector

For the consolidated central government data, revenues are reported on a cash basis, while expenditures are reported on an accrual basis. Due to technical problems, the authorities were not able to meet the submission deadline to report government finance data for publication in the *2003 Government Finance Statistics Yearbook (2003 GFS Yearbook).* Consequently, although the data for 2002 has been sent recently, the *2003 GFS Yearbook* (hardcopy) will only include information up to 2001. The data for 2002 will be processed for publication in the *GFS Yearbook*-CDROM. The authorities have prepared and sent to the Fund information on the components of consolidated central government expenditures by function. The *International Financial Statistics (IFS)* has published fiscal data through March 2003.

The coverage of national budget accounting is narrower than the fiscal accounting carried out in the program.

III. Monetary Sector

The central bank of Peru (BCRP) is responsible for the compilation and dissemination of monetary statistics. The BCRP prepares and publishes the analytical accounts of the banking system and of the central bank broadly in line with international standards. However, these statistics are disseminated only in a summary form.

IV. External Sector

The BCRP is responsible for the compilation and dissemination of balance of payments and international investment position statistics. The BCRP prepares quarterly data on the balance of payments and international investment position largely in line with the recommendations of the *Balance of Payments Manual, Fifth Edition (BPM5).* These data are reported to the Fund for publication in the *IFS* and the Balance of Payments Statistics Yearbook. Some departures from *BPM5* include the lack of coverage of assets held abroad and land acquisition abroad by residents; lack of separate identification of liabilities to affiliated enterprises; and not recording some external debt transactions on an accrual basis.

Regarding international reserves, the BCRP has been reporting since August 2001 weekly data in accordance with the *Operational Guidelines for Data Template on International Reserves and Foreign Currency Liquidity.* The BCRP includes the full amount of the liquidity requirements in the reserve template under official reserve assets, but does not register the contingent net drain (as specified in Section III of the Data Template). Peru started to disseminate quarterly data on external debt with a one-quarter lag in end-September 2003. External debt data are not compiled on an accrual basis, as recommended by *BPM5* and the *External Debt Statistics: Guide for Compilers and Users.*

Findings of the Data ROSC Mission

A ROSC data module mission visited Lima during February 12–26, 2003. Although Peru's macroeconomic statistics are to a large extent adequate for effective surveillance, the mission identified important shortcomings mainly in national accounts and price statistics.

The report found Peru having a legal and institutional framework that is broadly adequate to support the quality of official statistics and protect the confidentiality of individual respondents' data. The terms and conditions under which statistics are collected, processed, and disseminated are available to the public, as are studies and analyses of revisions to macroeconomic statistics. The timeliness and periodicity of most data series meet or exceed SDDS requirements. The methodologies used for compiling macroeconomic statistics broadly follow international standards, with the exception of the wholesale price index.

Statistical techniques and assessment and validation of source and intermediate data are weak for national accounts and, to a lesser extent, for prices and balance of payments statistics. Response rates for surveys are low, particularly for national accounts source data. There is limited coordination between the BCRP and the Ministry of Economy and Finance (MEF) concerning fiscal statistics. The needs of nongovernmental users of official statistics are not monitored, with the exception of the consumer price index. Statistics are, in general, consistent across sectors, but there are inconsistencies within the national accounts statistics.

The report found several areas where further improvements are needed, including: (i) coordination among the agencies that compile official statistics to avoid duplication of efforts and confusion among users; (ii) simultaneous release of price and national accounts data to all interested users, without privileged access to selected government officials; (iii) establishing an updated business register that provides the basis for sample surveys; (iv) implementing a new benchmark and base year for GDP; (v) adopting the methodology used for annual GDP to compile quarterly GDP estimates at a more aggregated level; (vi) expanding the coverage of the wholesale price index to include mining, oil and gas extraction, electricity and water, public transportation, and communication; (vii) assigning responsibility for compiling and disseminating GFS to a single agency; (viii) improving the reconciliation of GFS published by the BCRP with the fiscal statistics published by the MEF and the Accountant General's Office; (ix) expanding the coverage of the depository corporations survey; (x) preparing sectoral breakdowns of depository corporations and financial surveys in accordance with the *MFSM* methodology; and (xi) expanding the scope of data sources for compiling financial flows of individual residents.

Since June 2003, the BCRP has fully implemented the recommendation of expanding the coverage of the depositary corporations survey.

Lima, May 25, 2004

Dr. Anne Krueger
Acting Managing Director
International Monetary Fund
Washington, DC 20431

Dear Dr. Krueger:

1. In recent years, the Peruvian economy has continued to strengthen, and financial indicators have further improved. The government of Peru is firmly committed to continuing to foster robust and durable growth of output and employment, keep inflation low, reduce external vulnerabilities, and lay the basis for a marked reduction in poverty through prudent macroeconomic policies and a deepening of growth-enhancing reforms.

2. Policies for 2004 aim at consolidating the gains made in 2002–03, with sustained economic growth, low inflation, and a further strengthening in external balances. The economy is envisaged to grow by 4 percent, led by strong export performance, and inflation is projected at 2.5 percent by year-end. The external current account deficit is projected to narrow from 1.8 percent of GDP in 2003 to 0.7 percent in 2004, with an increase in net international reserves of at least US$100 million. Toward this end, the program will maintain prudent fiscal and monetary policies, while adopting growth-enhancing reforms. Quantitative performance criteria are presented in Table 1.

3. The combined public sector deficit is targeted to fall from 1.7 percent of GDP in 2003 to 1.4 percent in 2004 and 1 percent in both 2005 and 2006. These levels are expected to be covered by available multilateral and bilateral financing and net placements of government debt in the domestic and external markets. On this basis, public sector debt is expected to fall from 47½ percent of GDP in 2003 to about 41 percent of GDP by end–2006. The fiscal objectives of the program through end-June 2006 will be monitored on a quarterly basis through ceilings on the public sector borrowing requirement. The program also includes ceilings on the contracting or guaranteeing of nonconcessional medium- and long-term public debt and on the outstanding short-term external debt of the nonfinancial public sector. The government will stand ready to take any additional measures that may be needed to ensure that the fiscal targets are observed.

4. The objective of monetary policy is attainment of the inflation target of 1.5– 3.5 percent, according to the central bank's inflation targeting framework, in the context of a floating exchange rate regime. In recent months, weak agricultural crops, increases in world oil prices, and bottlenecks in transportation have led to a temporary rise in observed inflation, to the higher end of the inflation targeting range. However, some of these pressures are expected to subside in the near term and, by year-end, inflation is expected to fall back into the target range. Reserve requirements has been extended to all foreign exchange liabilities, and will continue to be managed prudently to ensure that the high level of coverage of dollar

deposits in the banking system by the international reserves of the BCRP is maintained. The program will include quarterly performance criteria floors on the accumulation of net international reserves by the central bank during 2004, and a consultation mechanism on inflation.

5. The attached Memorandum of Economic and Financial Policies (MEFP) presents the plans of the Government of Peru for 2004–06, which are based on an economic framework (*Hoja de Ruta*) reflecting broad-based consultation. In support of its program, the government requests a Stand-By Arrangement (SBA) from the Fund totaling SDR 287.279 million (20 percent of quota on an annual basis) and covering the period June 9, 2004 through August 16, 2006. The requested SBA would support government efforts to reduce the economy's vulnerability during the period through the change in administration in mid–2006. Accordingly, the government intends to treat the arrangement as precautionary.

6. The Government of Peru believes that the policies described in the attached MEFP are adequate for meeting the objectives of the program, but will take any steps that might may be needed for this purpose. The authorities of Peru will maintain a close and proactive policy dialogue with the Fund, in accordance with Fund policies on such consultations. There will be five semi-annual reviews under the program, and the first review will be completed by October 31, 2004. During the first review, the end-December limit on the borrowing requirement of the combined public sector may be adjusted by up to S/. 300 million, while assuring achievement of the program objectives.

Sincerely yours,

/s/
Pedro Pablo Kuczynski
Minister of Economy and Finance

/s/
Javier Silva Ruete, President
Central Reserve Bank of Peru

Table 1. Peru: Quantitative Performance Criteria
and Inflation Consultation Mechanism, 2004

	Jun.30	Sep. 30	Dec. 31
(Cumulative amounts from December 31, 2003, millions of new soles)			
Borrowing requirement of the combined public sector 1/ 2/	200	1,590	3,300
(Cumulative amounts from December 31, 2003, in millions of U.S. dollars)			
Net international reserves of the Central Reserve Bank, excluding foreign-currency deposits of financial institutions 3/4/5/6/	286	-44	-157
Outstanding short-term external debt of the nonfinancial public sector	50	50	50
Contracting or guaranteeing of nonconcesional public debt with maturity of at least one year 7/8/	2,050	2,675	3,200
Of which: external debt [1-5] years' maturity	100	100	100
External payments arrears of the public sector (on a continuous basis) 9/	0	0	0
(Consultation bands for the 12-month rate of inflation, in percent) 10/			
Outer band (upper limit)	5.5	5.5	5.5
Inner band (upper limit)	4.5	4.5	4.5
Central point	2.5	2.5	2.5
Inner band (lower limit)	0.5	0.5	0.5
Outer band (lower limit)	-0.5	-0.5	-0.5

1/ PIPP proceeds are included below the line.
2/ The limits on the borrowing requirement of the combined public sector will be adjusted upward, by a maximum amount of S./350 million for completion of two public investment projects (the Yuncan hydroelectric plant and other projects) financed with concessional lending under the PIPP.
3/ The target for net international reserves will be adjusted upward by the amount of PIPP proceeds in foreign currency in excess of US$40 million by end-June, US$70 million by end-September and US$110 million by end-December 2004. The amounts in excess will be deposited at the BCRP.
4/ The target for net international reserves will be adjusted upward by the amount that the net foreign borrowing of the nonfinancial public sector exceeds US$500 million at end-June, US$585 million at end-September and US$665 million at end-December 2004. The amounts in excess will be deposited at the BCRP.
5/ The target for net international reserves will be adjusted downward for shortfalls from the combined program amounts of PIPP proceeds and net foreign borrowing. This downward adjustment will not exceed US$350 million at end-June, US$500 million at end-September and US$500 million at end-December 2004. In this case 3/ and 4/ will not apply.
6/ The target for net international reserves will be adjusted downward for withdrawals for portfolio management purposes of deposits held at the Central Reserve Bank by the Consolidated Pension Reserve Fund (FCR) and any other funds managed by the ONP. This downward adjustment will not exceed US$300 million at any time in 2004.
7/ The limit would be adjusted upwards by any amount of debt issued for, and used in, a debt-exchange operation, and by up to US$1 billion for prefinancing of government operations in 2005.
8/ The limit would be adjusted upwards by the total amount of private public partnerships (PPPs) where the government issues guarantees on borrowing by private firms up to a maximum of US$400 million.
9/ Excluding arrears associated with nonrescheduled debt to foreign creditors outstanding as of end-2003.
10/ Should inflation fall outside the inner band, the authorities will discuss with the Fund staff the appropriate policy response. Should inflation fall outside the outer band, the authorities will also complete a consultation with the Executive Board of the Fund on the proposed policy response before requesting further purchases under the arrangement.

MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES FOR 2004–06

1. Under its economic program for 2002–03, supported by the Stand-By Arrangement from the Fund, Peru made progress in stabilizing its economy and implementing growth-enhancing reforms. Economic growth averaged 4½ percent a year, inflation remained low in the context of the inflation targeting framework adopted in early 2002, and the external position strengthened significantly, reflecting strong export performance and substantial private capital inflows. The Government of Peru also made progress in advancing a series of reforms related to the tax regime, fiscal decentralization, the pension system, the introduction of fiscal rules, the granting of operating concessions of state assets, and prudential regulations and oversight of the financial system. During the program period, vulnerabilities associated with dollarization and relatively high external debt and debt service levels were reduced. However, the government is committed to further reduce vulnerabilities and bring down still high unemployment and poverty rates.

2. The government's economic program for 2004–06 is aimed at consolidating the gains made in recent years and promoting sustained economic growth and employment creation through the continuation of prudent macroeconomic policies and a deepening of the reform effort. Over the program period, real GDP is projected to grow by 4½ percent a year, supported by strong export performance, and 12-month inflation is forecast at about 2.5 percent. Gross official international reserves are targeted to continue to cover more than 100 percent of the banking system's dollar-denominated liabilities and more than twice the stock of short-term external debt on a residual maturity basis.

3. The primary surplus of the combined public sector is projected to improve significantly in 2004, from 0.4 percent of GDP in 2003 to 0.8 percent. Central Government tax revenue is projected to rise by 0.3 percentage points of GDP to 13.3 percent of GDP, reflecting the introduction of the tax on financial transactions, higher income tax collections associated with improved export prices, improvements in tax administration, and the elimination of distortionary taxes. The tax on financial transactions has been reduced from an initial rate of 1.5 per thousand to 1.0 per thousand in March 2004, and further reductions to 0.8 per thousand and to 0.6 per thousand have been approved for end-December 2004 and end-December 2005, respectively. To generate additional resources needed for the provision of infrastructure and social services in the regions, the government will work with congress to eliminate regional tax exemptions in at least two regions by end-September 2004.

4. In 2004, expenditure growth will also be restrained. The growth in general government noninterest expenditure in real terms will be limited to less than 3 percent in real terms (applying the GDP deflator). General government noninterest current outlays will be maintained below S/. 32.6 billion. Capital expenditure of the general government will be stepped up to S/. 6.2 billion (2.6 percent of GDP), with emphasis on infrastructure and roads. Further public investment in roads and other high priority infrastructure, consistent with sustainable debt dynamics and transparent fiscal accounting, will be promoted on the basis of innovative financial mechanisms. There will be a more active promotion of private

investment in infrastructure, through public-private partnerships (PPPs) and more conventional concession arrangements.

5. In order to contribute to medium term fiscal sustainability, the government will undertake public liability management. It will aim to expand placements in medium- and long-term local currency instruments, with a view to reducing rollover and currency risks. Likewise, the government will seek to lengthen the maturity of new placements abroad and to extend the maturity of existing debt through voluntary debt swap operations, among others. All external bond issues will have collective action clauses. To increase the flexibility of debt management, the government will introduce an overall ceiling on central government borrowing to replace the specific ceilings for domestic and external borrowing.

6. Monetary policy will continue to be guided by the inflation targeting framework, with the target set at 2.5 percent (within a band of ± 1 percent). The central bank will maintain a strong official international reserve position, in the context of Peru's inflation targeting framework.

7. To foster robust economic growth and employment and make room for higher priority social and infrastructure expenditure, the Government is deepening reforms aimed at increasing the cyclical stability of the economy, increasing the level and efficiency of public and private investment in infrastructure, encouraging private investment in productive capacity and housing, furthering Peru's integration into the regional and world economy, and streamlining public sector operations (Table 1 presents the growth enhancing policy actions for 2004). Toward these aims, the government will:

- ***Private investment.*** Grant privately operated concessions for public asset management, particularly in the area of transportation infrastructure; develop Public-Private Partnerships (PPPs), including for road construction and maintenance; bolster property rights by putting in place commercial courts in Lima and other cities with the purpose of expediting the settlement of business-related legal disputes.

- ***Public investment.*** Fiscal reforms aimed at protecting public investment levels and ensuring a more efficient execution of capital projects will continue to be implemented, with a view to avoiding the use of public capital expenditure as the variable that absorbs changes in the fiscal accounts. Furthermore, the government will explore the scope for innovative financial mechanisms that could be implemented to raise public investment in a noninflationary way, consistent with debt sustainability and transparent fiscal accounting.

- ***Job creation in the formal economy.*** Gradually lower the taxes on and regulatory costs of labor, which presently are equivalent to 60 percent of wages and undermine effective worker protection; and further promote trade opening and free trade agreements, including to accelerate the growth of labor intensive export industries.

- ***Public sector reform***. In order to improve resource management in the public sector, carry out a comprehensive reform of the pension regimes, including the preferential *Cédula Viva* regime; ensure that the pricing policy of state enterprises is consistent with market conditions; reinforce efforts to improve the efficiency and equity of the tax system by strengthening tax administration and eliminating distortionary taxes; and phase out sectoral and regional tax exemptions to generate additional resources needed for the provision of infrastructure and social services in the regions. Implement a comprehensive reform of the pension regimes for the police and the military. The reform would include raising individual contribution rates and improving administration.

- ***Decentralization.*** Complete the legal framework for a gradual and fiscally neutral decentralization that ensures delivery of essential public services.

- ***Poverty reduction.*** Improve the efficiency of social expenditure and strengthen the targeting of poverty reducing programs with the assistance of the Inter-American Development Bank (IADB) and the World Bank.

- ***Capital markets***. Further strengthen financial sector regulations and supervision, including in the context of the new Basle regulations, promote dedollarization, and support the development of domestic capital markets to increase the access and quality of credit, including through strengthening the basis for collateralization.

8. To promote higher investment and growth, the government of Peru has recently sold its minority shareholdings in an oil refinery, granted in concession a hydro-electrical project, and will shortly grant two important mining concessions. It will also issue the calls for bids to award in concession to the private sector the operation and maintenance of a port terminal by end-December 2004. In the area of road infrastructure, the government will seek to award concessions or PPPs by December 2004 for the construction and maintenance of at least two major roads. It will ensure that any government outlays, debt guarantees, or contingent obligations associated with concessions, PPPs, or any other financial mechanisms, are recorded transparently in the fiscal accounts and the public sector debt.

9. The Judiciary is implementing a program to strengthen property rights, with IDB support. In particular, it is establishing commercial courts modules to adjudicate commercial disputes and speed-up contract enforcement.

10. The government will continue to promote employment in the formal sector of the economy and improve effective worker protection. To reduce non-wage labor costs, the government will submit to congress legislation to eliminate by end-December 2004 the 1.7 percent wage tax (IES).

11. In the area of public pensions, the government has already introduced in congress a constitutional amendment to allow for the submission of draft laws aimed at a comprehensive reform of the preferential public pension system (*Cédula Viva*, CV). The reform shall include

centralizing the administration of the CV to improve its management and eliminate fraudulent payments, closing the CV system to new entrants, and eliminate the link between wage increases and pensions.

12. The government will undertake a reform of the civil service and improve the regulation of domestic fuel prices, with a view to improving efficiency and governance. Consistent with the recently approved general Public Employment Law, the government will submit to congress legislation that regulates employment conditions for government employees by end-December 2004. Also, government employment and payroll will be fully computerized, and a census of government employees and pensioners will be completed by end-September 2004. From June 2004, a new system will be introduced to ensure that prices of the state oil company PETROPERU are adjusted in an automatic and transparent way to keep them in line with market prices.

13. The government is pressing ahead with decentralization and related efforts to reduce poverty, with assistance from the World Bank and IDB. Consistent with the recently approved Fiscal Decentralization Law, controls on reporting, spending and borrowing by sub-national governments will be strengthened and their administrative capacity improved. The legal framework will be further enhanced to ensure that decentralization is implemented in a fiscally-neutral manner. In particular, by end-December 2004, the government will submit to congress three laws requiring: (i) specification of the criteria for central government certification of sub-national governments' administrative capacity to deliver public services effectively *(Ley del Sistema Nacional de Acreditación)*; (ii) consolidation of regions (*Ley de Incentivos para la Integración y Conformación de Regiones*); and (iii) clarification of the distribution of functional responsibilities among the different levels of government *(Ley del Poder Ejecutivo*). In addition, regulations will be issued by end-December 2004 that specify remedial measures for sub-national governments that are not compliant with fiscal rules.

14. The government will continue its efforts to further strengthen financial regulation and supervision. During 2004, the Peruvian authorities will: (i) announce a plan to improve collateral registries; (ii) enhance the supervision and regulation of operational risk of financial institutions, including insurance companies; (iii) start implementing rules requiring specific qualifications for personnel of financial institutions in charge of evaluating financial investments; and (iv) further promote the reduction of risks associated with dollarization. To develop the domestic capital market and further diversify investment opportunities of private pension funds, the government will promote the creation of alternative financial instruments in order to allow domestic savings to be allocated to private investment. To that effect the limits on AFP investments abroad have recently been increased by 1.5 percentage points. Steps also will be taken to enhance the legal protection of employees of the Superintendency of Banks. Consistent with existing legislation, the government will maintain a unified and unrestricted exchange system, and a foreign trade regime free of import restrictions for balance of payments reasons.

15. Public bank lending to the private sector will continue to be closely monitored. Net lending under the Banco de la Nación consumer-lending program to aid low-income public

sector employees and pensioners (Multired) will continue to be managed conservatively, and will not exceed S/. 700 million at the end of 2004. With respect to Banco Agrario, its operations will continue to channel foreign lines of credit to agricultural producers, and its quasi-fiscal operations associated with lending to small-scale farmers will continue to be recorded in the budget.

Table 1. Peru: Growth Enhancing Policy Actions for 2004

1. Structural Performance Criteria	
Begin operations of a commercial court in Lima.	September 30
Grant concessions or enter into Public Private Partnerships for the construction and maintenance of at least two major roads.	December 31
2. Structural Benchmarks	
Announce a plan to centralize the information on collateral registries.	June 30
Submit to Congress legislation to eliminate by end-December the special wage tax (IES).	September 30
Complete a census of government employees and pensioners	September 30
Develop a satisfactory action plan for reforming the pension regimes for the police and the military.	September 30
Introduce in congress a constitutional amendment and, once approved, introduce in Congress draft laws to allow a comprehensive reform of the *Cédula Viva,* as described in paragraph 11 of the MEFP.	December 31
Implementation of a satisfactory law clarifying shared functional responsibilities among the national, regional, and local governments.	December 31
Implementation of a satisfactory law providing objective criteria for certifying that regional governments have the administrative capacity to take on devolved expenditure (*Ley del Sistema Nacional de Acreditación*).	December 31
Put in full operation a system within the SBS to measure currency risks.	December 31

TECHNICAL MEMORANDUM OF UNDERSTANDING (TMU)

This Memorandum includes definitions of concepts and the format for periodic reporting to the Fund on performance under the program for 2004 described in the letter of the Government of Peru dated May 25, 2004.

I. DEFINITIONS OF CONCEPTS[1]

1. **The borrowing requirement of the combined public sector (PSBR)** will be measured as: (a) net domestic financing of the nonfinancial public sector (NFPS); plus (b) net external financing of the NFPS; plus (c) proceeds from the Private Investment Promotion Program (PIPP); and less (d) the operating balance of the BCRP. The PSBR will be adjusted to exclude the impact of data revisions that do not represent a change of its flows during 2004. The **NFPS** comprises the central government, the autonomous agencies, the local and regional governments, and the nonfinancial public enterprises. The components of the PSBR (Table 1), will be defined and measured as follows:

(a) **The net domestic financing of the NFPS** is defined as the *sum* of: (i) the increase in net claims of the domestic **financial system**[2] on the nonfinancial public sector (excluding Peruvian Brady bonds and other government bonds initially sold abroad); (ii) the net increase in the amount of public sector bonds[3] held outside the domestic financial system and the nonfinancial public sector, excluding Peruvian Brady bonds and other bonds initially sold abroad; and (iii) the increase in the floating debt of the nonfinancial public sector due to expenditure operations and tax refund arrears; *less* (iv) the accumulation of stocks, bonds, or other domestic financial assets by the nonfinancial public sector and (v) the amortization of pension recognition bonds. In the case of enterprises that are divested after December 31, 2003, the net credit of the financial system to these enterprises will be recorded, for the remainder of the program period, as unchanged from their level at the time of the PIPP.

(b) **The net external financing of the NFPS** comprises (i) disbursements of loans; plus (ii) receipts from the issuance of government bonds abroad; minus (iii) cash payments of principal (current maturities of both loans and bonds); minus (iv) cash payments of arrears (principal and interest); plus (v) the net increase (or, minus the decrease) in short-term

[1] For purposes of the program for 2004, operations in foreign currency will be valued at S/ 3.49 per U.S. dollar.

[2] The **financial system** comprises the banking system, the Corporación Financiera de Desarrollo (COFIDE), and all other nonbank financial intermediaries. The banking system comprises the Central Reserve Bank of Peru (BCRP), the commercial banks, the Banco de la Nación (BN), Banco Agropecuarillar.

[3] Excluding the new issuances of pension recognition bonds.

external debt; minus (vi) debt buy-backs or other prepayments of debt (at market value) not included in the following item (including repayments of short-term external debt assumed by the government at the time of the divestiture of public enterprises, net of the proceeds from the sale of inventories of such enterprises); minus (vii) debt-equity swaps used in the PIPP accounted at the market value of these papers as defined by ProInversion; minus (viii) the net increase (or, plus the decrease) in foreign assets of the nonfinancial public sector (including those held abroad by the Fondo Consolidado de Reservas (FCR), and any other fund managed by the Oficina de Normalización Previsional (ONP)) (Table 2).

(c) **PIPP proceeds** are defined as (i) the cash payments received by the Treasury from the sale of state-owned assets (including proceeds transferred to the FCR, and any other specialized funds) valued at the program exchange rate, plus (ii) debt equity swaps used in the PIPP, accounted at market values as defined by ProInversion. PIPP proceeds also include up-front payments received by the Treasury for the granting of concessions for public services but exclude the annual payments under the concession program, which are part of central government nontax revenue.

(d) **The operating balance of the BCRP** includes: (i) cash interest earnings of the BCRP minus cash interest payments by the BCRP, in both domestic and foreign currency; (ii) the administrative expenses of the BCRP; and (iii) any realized cash losses or gains from activities in currencies, financial instruments, and derivatives.

2. **The consultation bands for inflation** are based on the 12-month rate of change in consumer prices as measured by the *Indice de Precios al Consumidor (IPC)* at the level of Metropolitan Lima by the *Instituto Nacional de Estadística e Informática* (INEI). Should inflation fall outside an inner band of 2 percentage points around the central point of 2.5 percent, the authorities will discuss with the Fund staff on an appropriate policy response. Should inflation fall outside an outer band of 3 percentage points around the central point, the authorities will also complete a consultation with the Executive Board of the Fund on the proposed policy response before requesting further purchases under the program.

3. **The net consumer lending of the BN** will be defined as disbursements of loans under the "Multired Program", established in November 2001, less cash amortizations under the loan program. Interest payments on these loans are excluded from the definition of net lending.

4. **The net international reserves of the BCRP, excluding foreign-currency deposits of financial institutions,** are defined for the purpose of the program as: (a) the foreign assets of the BCRP (excluding subscriptions to the IMF and the Latin American Reserve Fund (FLAR), Pesos Andinos, credit lines to other central banks, Corporación Andina de Fomento (CAF) bonds, and foreign assets temporarily held by the BCRP as part of swap operations); less (b) reserve liabilities, defined as the sum of: (i) the BCRP's external liabilities with an original maturity of less than one year, and (ii) its liabilities to the IMF, to the Inter-American Development Bank (IADB) and to the FLAR; and less (c) deposits in foreign currency by the

banking system, other financial intermediaries and the private sector, net of repos of Treasury bonds with the financial system.

5. **BCRP's silver holdings** will be included in the net domestic assets and excluded from the net international reserves. The gold holdings of the BCRP will be accounted at US$415.0 per troy ounce (the average book value as of December 31, 2003), SDRs at US$1.48597 per SDR, and foreign currency assets and liabilities of the BCRP in other currencies at the exchange rate of December 31, 2003. Net international reserves will be adjusted to exclude any valuation gains or losses resulting from net sales or deliveries of gold by the BCRP. The end-December 2003 level of net international reserves is shown in Table 3.

6. The flows of the **short-term external debt of the NFPS** are defined as the net change in the NFPS's outstanding external indebtedness with a maturity of less than one year (including instruments with put options that would be triggered within one year of the contracting date), measured, in part, on the basis of the operations of a selected sample of public enterprises comprising Petroperú, and Electroperú. These limits exclude normal import financing but include forward commodity sales. In the case of companies sold to the private sector under the PIPP, the short-term debt of these entities will be recorded, for the remainder of the program period, as unchanged from their level at the time of the PIPP. The end-December 2003 stock of short-term external debt of the NFPS is shown in Table 4.

7. **The contracting or guaranteeing of nonconcessional public debt with a maturity of at least one year** refers to all domestic and external obligations of the NFPS, COFIDE, the BCRP, the BN, and any other public financial entity, except for loans classified as reserve liabilities of the BCRP. The program limits on nonconcessional debt will exclude: (i) any new loans extended in the context of a debt rescheduling or debt reduction operation; (ii) any lending at concessional terms; and (iii) certificates (BCRPCD) issued by the BCRP for conducting monetary policy.

8. **For the purpose of the performance criterion on the contracting or guaranteeing of public debt,** external public debt applies also to commitments contracted or guaranteed for which value has not been received. In this regard, the term "debt" has the meaning set forth in point No.9 of the Guidelines on Performance Criteria with respect to Foreign Debt adopted on August 24, 2000 (Board Decision No. 12274-(00/85)). Thus, the term "debt" will be understood to mean a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time: these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being as follows: (i) loans, i.e., advances of money to the obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans, and buyers' credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by

repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements); (ii) suppliers' credits, i.e., contracts where the supplier permits the obligor to defer payments until some time after the date on which the goods are delivered or services are provided; and (iii) leases, i.e., arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lessor retains the title to the property. For the purpose of the performance criterion, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair or maintenance of the property. Under the definition of debt set out above, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.

9. For program purposes, **a debt is concessional** if it includes a grant element of at least 35 percent, calculated as follows: the grant element of a debt is the difference between the net present value (NPV) of debt and its nominal value, expressed as a percentage of the nominal value of the debt (i.e., grant element is equal to (nominal value minus NPV) divided by nominal value). The NPV of debt at the time of its disbursement is calculated by discounting the future stream of payments of debt service due on this debt. The discount rates used for this purpose are the currency specific commercial interest reference rates (CIRRs), published by the OECD. For debt with a maturity of at least 15 years, the ten-year average CIRR will be used to calculate the NPV of debt and, hence, its grant element. For debt with a maturity of less than 15 years, the six-month average CIRR will be used. For the purposes of the program through December 2004, the CIRRs published by the OECD in December 2003 will be used (Table 5).

10. **The concessionality of loans in currency baskets** will be assessed on the basis of U.S. dollar interest rate tables. For loans with interest rates based on the internal policy of the creditors, the relevant interest rate to define concessionality will be the interest rate for each creditor at the time of the commitment. Loans or portions of loans extended in the context of a debt rescheduling or a debt reduction operation will be excluded from the ceiling.

11. **The external payments arrears of the public sector** include arrears to multilateral financial institutions, to Paris Club creditors, and to other foreign creditors with whom debt restructuring agreements have been concluded. They exclude arrears outstanding at end–2003 that were not covered under restructuring agreements. The public sector will be defined to include the NFPS, COFIDE, the BCRP, the BN, and any other state development bank.

12. **Definitions used in Table 1 of the letter of intent dated May 25, 2004 for the calculation of adjustments to limits and targets for net international reserves:**

a. **PIPP proceeds in foreign currency** are calculated as (a) PIPP proceeds as defined above in Section I.1.c, less (b) domestic currency PIPP proceeds.

b. **Net foreign borrowing** (Table 2) is defined as the sum of disbursements of loans (I.1.b.i), excluding disbursements up to S/. 350 million for completion of a public investment project financed with concessional lending under the PIPP, mentioned in footnote 2 of Table 1 attached to the letter of intent; plus receipts from the issuance of government bonds abroad (I.1.b.ii); minus cash payments of principal (I.1.b.iii); minus cash payments of arrears (principal and interest) (I.1.b.iv); plus the net increase (or minus the decrease) in short-term external debt (I.1.b.v).

c. **The withdrawals for portfolio management purposes** of deposits held at the BCRP by the FCR and any other fund managed by the ONP, mentioned in footnote 6 of Table 1 attached to the letter of intent refer to placements of funds that are in accord with an investment plan approved by the Board of the FCR, excluding deposits in public financial institutions and government securities.

d. Prefinancing mentioned in footnote 7 is understood as the portion of nonproject related external public debt, contracted or guaranteed, that is issued in 2004 but will be used in 2005 or later.

II. PERIODIC REPORTING

13. The regular reporting will include the following:

(a) The latest **Nota Semanal** of the BCRP
(b) Monthly Report

(i) **Performance criteria**
Data on the program's quarterly *quantitative* performance criteria.

(ii) **Financial sector**
(a) Balance sheets of the consolidated financial system, consolidated banking system, BCRP, BN, commercial banks, Banco Agropecuario, and development banks in liquidation.
(b) Disaggregation of the net domestic assets of the BCRP and BN with details of the other net accounts.
(c) Monthly balance sheet of COFIDE and data on COFIDE guarantees.
(d) BCRP daily operations.
(e) Monthly balance sheet of the private pension system.
(f) Evolution of gross disbursements and amortizations of consumer loans made under the "Multired Program".
(g) The stock of government guarantees for housing support programs and the monthly balance sheet of Mivivienda.

(iii) **Fiscal sector**
(a) PSBR as defined in Table 1.

(b) List of domestic and external debt instruments contracted or guaranteed by the public sector, including data on the amount, lender, grace period, maturity, and interest rate (refinancing credits should be labeled as such), collateral guarantees, any instrument enhancements (such as but not limited to put or call options) that affect the price or maturity of the debt instrument.

(c) Summary of disbursements and interest and amortization due and paid (identifying the payments of arrears) of loans included in the records of the General Directorate of Public Credit by creditor and debtor, indicating foreign origin (distinguishing between financial and nonfinancial public sector debt) and domestic origin (Table 6).

(d) Cash operations of the treasury (which includes floating debt, with a memorandum item on tax refund arrears).

(e) Data on PIPP revenue, which will include gross receipts, costs of the PIPP, use of debt-for-equity swaps, commissions received by ProInversion and the resulting cash receipts received by the Treasury and the FCR. In addition, the report will include debts assumed by the government in connection with the PIPP.

(f) Operations of the Central Government, Central Government Current Revenue (SUNAT Format); Central Government Noninterest Expenditure; and Transfers from the Central Government to the Rest of the General Government.

(g) Fuel prices of PETROPERU and RELAPASA, and international prices of products commercialized by PETROPERU including tariffs, indirect taxes and distribution margins (prices would be listed for all grades of gasoline, diesel fuel, kerosene and fuel oils.)

(h) Stocks of the central government PIPP accounts in the BCRP and the BN.

(iv) **External sector**

(a) Summary of imports and exports by product (volume and price).

(b) Daily exchange rate statistics.

(v) **Quarterly data of fiscal and external accounts, and public sector debt,** distinguishing between total public sector debt and total NFPS.

(vi) **Other**

(a) Summary of legislative changes pertaining to economic matters.

(b) BCRP circulars.

(c) BCRP inflation report.

Table 1. Peru: Public Sector Borrowing Requirement 2003

(In millions of nuevos soles)

	Stock as of Dec. 31 1/		
	2002	2003	Flow
a. Net domestic financing of the nonfinancial public sector	**-785**	**-331**	**455**
i. Net claims of the financial system (1+2+3)	-9,598	-8,827	770
1. Net credit of the banking system on the NFPS and COFIDE	-11,911	-11,717	194
Credits	7,925	7,552	-373
Liabilities	19,836	19,269	-567
2. Net credit of COFIDE on the banking system	1,442	1,119	-323
Credits	1,647	1,200	-447
Liabilities	205	81	-124
3. Net credit of nonbanking financial institutions on the NFPS	872	1,770	899
Credits	1,570	2,740	1,169
Liabilities	699	969	270
ii. Stock of NFPS bonds in circulation (excluding bonds held by NFPS and the financial system)	9,874	9,856	-18
1. Total	14,838	15,812	974
2. Less: holdings of the financial system (including COFIDE)	4,749	5,723	974
3. Less: holdings of nonfinancial public sector entities	214	233	19
iii. Floating debt	957	1,485	528
iv. Less: Accumulation of stocks, bonds, or other domestic financial assets by the NFPS	2,019	2,260	241
v. Less: issuance of pension recognition bonds in program period	0	584	584
b. Net external financing			**2,921**
(Millions of US dollars)			837
c. Privatization			**181**
(Millions of US dollars)			52
d. Operating balance of the BCRP			**121**
PSBR (a+b+c-d)			**3,436**

1/ Foreign currency valued at US$1 = S/. 3.49.

Table 2. Peru: Net External Financing N.F.P.S. 2003–2004
(In millions of U.S. dollars)

		2003	2004 Prog.			
			Jan–Mar	Jan–June	Jan–Sep	Jan–Dec
i.	Loan Disbursements	855	304	621	1,004	1,461
	-Projects	336	104	212	358	450
	-Non Projects	519	200	409	646	1,011
ii.	Bonds	1,246	500	500	500	500
iii.	Cash payments on amortization	-1,130	-292	-628	-923	-1,307
	- Loans	-1,085	-258	-595	-857	-1,240
	- Bonds	-44	-33	-33	-67	-67
iv.	Cash payments to settle arrears	0	0	0	0	0
v.	Change in short term debt (increase+)	65	0	0	0	0
A.	**Net foreign borrowing (i+ii-iii-iv+v)**	**1,037**	**512**	**493**	**581**	**654**
vi.	Prepayments	0	0	0	0	0
vii.	Debt equity swaps	0	0	0	0	0
viii.	Change in foreign assets held by the NFPS	200	0	45	60	60
B.	**Net external financing (A-vi-vii-viii)**	**837**	**512**	**448**	**521**	**594**

Source: Central Reserve Bank of Peru.

Table 3. Peru: Net International Reserves of the Central Reserve Bank of Peru excluding Foreign Currency Deposits of Financial Institutions as Defined in the Technical Memorandum of Understanding (TMU)

(In millions of US$)

		Stocks as of Dec. 31, 2003
a.	**Assets**	**9,866**
	Deposits abroad	3,503
	Securities	5,877
	Gold 1/	463
	Holdings of SDR 2/	10
	Reciprocal credit agreement	3
	Cash	10
	Others	0
b.	**Liabilities**	**12**
	Reciprocal credit agreement	8
	Liabilities with international organizations	**3**
	IMF 2/	0
	IADB	3
	FLAR	0
c.	**Foreign currency deposits of financial institutions at the Central Bank**	**2,948**
	Banking enterprises	2,687
	Banco de la Nación	154
	COFIDE	55
	Financial enterprises	52
d.	**Treasury bond repos**	**0**
e.	**Swaps**	**0**
f.	**Valuation US$/other currencies**	**0**
g.	**Net international reserves - Program definition (a-b-c+d-e-f) 3/**	**6,906**
Memorandum items:		
1.	Subscription to the IMF and FLAR	313
2	Pesos andinos	20
3.	CAF bonds	7
4.	Net international reserves, official definition (g+c+1+2+3)	10,194

Source: Central Reserve Bank of Peru.

1/ Gold valued at US$415.00.

2/ Valued at US$1.48597 per SDR.

3/ As defined in I.4.

Table 4. Peru: Short Term External Debt Owed by the Non Financial Public Sector as of December 31, 2003

(In millions of US$)

	Export Financing	Working Capital	Import Financing	Total
Total	**0**	**0**	**99**	**99**
Petroperu	0	0	99	99
Electroperu	0	0	0	0
General government	0	0	0	0
Memorandum item:				
Total of export financing plus working capital loans	0	0	0	0

Source: Central Reserve Bank of Peru and state companies.

Table 5. Peru: Commercial Interest Reference Rates (CIRRs)

Note: the latest six-month CIRRs averages are to be used for loans whose maturity is less than 15 years. For all others use 10-year averages.

Average CIRRs (updated Dec 10, 2004)			Previous rates for loans with maturity =>15 years contracted in					
	Six-Month	Ten-Year	Before 1999	1999	2000	2001	2002	2003
	08/15/03-02/14/04	1/94 - 12/03 1/	1/86-12/95	1/89-12/98	1/90-12/99	1/91-12/00	1/92 - 12/01	1/93 - 12/02 1/
Australian Dollar	6.45%	7.48%	12.15%	10.15%	9.28%	8.55%	7.98%	7.68%
Austrian Schiling 2/	n.a.	6.03%	8.35%	7.73%	7.65%	7.43%	6.72%	6.34%
Belgian Franc 2/	n.a.	6.44%	9.25%	8.60%	8.45%	8.13%	7.21%	6.80%
Canadian Dollar > 8.5 years	5.24%	7.05%	9.83%	8.90%	6.07%	6.78%	7.41%	7.34%
Danish Krone	5.02%	6.37%	10.37%	8.88%	8.33%	7.80%	7.29%	6.81%
Finnish Markkaa 2/	n.a.	6.43%	10.64%	9.32%	9.15%	8.72%	7.56%	6.92%
French Franc 2/	n.a.	6.16%	9.62%	8.42%	8.19%	7.82%	6.95%	6.50%
German Mark 2/	n.a.	5.96%	7.91%	7.62%	7.54%	7.27%	6.58%	6.23%
Irish Punt 2/	n.a.	6.50%	10.37%	7.59%	8.36%	8.44%	7.44%	6.97%
Italian Lira 2/	n.a.	6.94%	11.50%	10.38%	10.06%	9.71%	8.30%	7.61%
Japanese Yen	1.92%	2.45%	5.53%	4.65%	4.30%	3.75%	3.17%	2.77%
Korean Won	5.94%	9.55%	n.a.	n.a.	n.a.	11.57%	10.74%	10.19%
Netherlands Guilder >8.5 years 2/	n.a.	6.43%	8.08%	5.24%	5.81%	6.52%	6.95%	6.75%
New Zealand dollar	6.36%	7.80%	12.17%	9.62%	8.90%	8.33%	7.97%	7.94%
Norwegian Krone	5.27%	7.04%	11.27%	8.93%	8.36%	7.94%	7.60%	7.28%
Spanish Peseta 2/	n.a.	7.20%	12.99%	11.35%	10.89%	10.31%	8.65%	7.92%
Swedish Krona	5.31%	7.08%	11.67%	10.10%	9.42%	8.61%	8.04%	7.52%
Swiss Franc	3.39%	4.55%	6.68%	3.78%	5.97%	5.67%	5.26%	4.85%
U.K. Pound	5.69%	7.16%	10.37%	9.53%	8.99%	8.38%	7.85%	7.41%
U.S. Dollar > 8.5 years	4.75%	6.63%	8.62%	7.93%	7.59%	7.35%	7.06%	6.85%
Euro (ECU for ten-year avg)	4.85%	6.07%	8.56%	7.99%	7.82%	7.13%	6.79%	6.40%
Memorandum:								
SDR 3/	4.46%	5.90%	8.22%	7.51%	7.21%	6.85%	6.49%	6.17%

1/ Estimates based on actual CIRRs for 1/94 to 12/03.
2/ For the current 10-year averages, rates for Euro are used from 1/99.
3/ The 10-year SDR denominated CIRR rate was constructed based on the weighted average of the five 10-year CIRR averages for the underlying currencies. For details for six-month and ten-year SDR CIRR averages, please refer to "current CIRR_SDR" sheet in this workbook.

Previous six-month rates

	loans with maturity <15 years, contracted between:										
		2/15/99 and **8/14/99**	8/15/99 and **2/14/00**	2/15/00 and **8/14/00**	8/15/00 and **2/14/01**	2/15/01 and **8/14/01**	8/15/01 and **2/14/02**	2/15/02 and **8/14/02**	8/15/02 and **2/14/03**	2/15/03 and **8/14/03**	8/15/03 and **2/14/04**
based on rates:	2/15 thru 8/14/1998	8/15/98- 2/14/1999	2/15 thru 8/14/1999	8/15/99- 2/14/2000	2/15 thru 8/14/2000	8/15/00- 2/14/2001	2/15 thru 8/14/01	8/15/01- 2/14/02	2/15 thru 8/14/03	8/15/02- 2/14/03	2/15/03- 8/14/03
Australian Dollar	6.42%	6.01%	6.34%	7.20%	7.47%	6.99%	6.27%	6.18%	6.83%	6.23%	5.83%
Austrian Schiling	5.59%	4.99%	n.a	n.a	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Belgian Franc	5.99%	5.24%	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Canadian Dollar > 8.5 years	6.27%	6.12%	6.20%	6.88%	7.26%	6.80%	6.24%	6.17%	6.21%	5.69%	5.50%
Danish Krone	5.77%	5.44%	4.72%	5.71%	6.46%	6.55%	6.01%	5.66%	6.15%	5.48%	4.85%
Finnish Markkaa	5.52%	5.04%	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
French Franc	5.71%	5.03%	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
German Mark	5.57%	4.86%	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Irish Punt	5.69%	4.93%	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Italian Lira	5.31%	5.22%	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Japanese Yen	2.32%	2.28%	2.13%	2.05%	1.98%	2.02%	1.58%	1.55%	1.95%	1.64%	1.45%
Korean Won	n.a.	n.a.	n.a.	10.51%	10.18%	8.85%	7.91%	7.42%	7.95%	7.00%	6.11%
Netherlands Guilder >8.5 years	6.12%	5.43%	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
New Zealand dollar	8.17%	6.76%	6.64%	7.74%	8.08%	7.57%	7.16%	7.10%	7.51%	7.00%	6.45%
Norwegian Krone	6.11%	6.58%	5.97%	6.82%	7.51%	7.98%	7.96%	7.46%	7.75%	7.34%	5.97%
Spanish Peseta	5.68%	4.98%	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Swedish Krona	6.04%	5.38%	4.78%	6.19%	6.46%	6.03%	5.63%	5.89%	6.42%	5.85%	5.22%
Swiss Franc	4.07%	3.91%	3.81%	4.50%	5.24%	5.17%	4.17%	3.89%	4.05%	3.06%	2.88%
U.K. Pound	7.15%	6.53%	5.79%	6.97%	7.03%	6.59%	6.11%	5.96%	6.17%	5.60%	5.22%
U.S. Dollar > 8.5 years	6.63%	5.92%	6.37%	7.18%	7.54%	6.86%	6.09%	5.67%	5.86%	4.75%	4.38%
ECU/Euro	5.36%	4.72%	4.72%	5.82%	6.27%	6.15%	5.73%	5.53%	5.91%	5.27%	4.73%
SDR	5.59%	5.01%	5.02%	5.80%	6.07%	5.88%	5.31%	5.04%	5.32%	4.53%	4.13%

Sources: OECD; and Fund staff calculations.

Table 6. Peru: Stock of Domestic Debt of the NFPS
(as of December 31, 2003)

	Legal Norm	Gross placements		Stock (estimated)
		Currency	Amount	(Millions of Nuevos Soles)
Credits from BN				**4,026**
Credit to central government		US$ / S/. / Y		3,099
Credit to local governments		US$ / S/.		253
Net public treasury overdraft		S/.		674
Bonds				**6,001**
Capitalización BCRP	D.S.066-94-EF	S/.	614	226
Serie A			239	226
Serie B			375	0
Bonos TP - Financial system strengthening	D.U. 041-99	US$	175	363
Bonos TP - Temporal suscription of stocks	D.U. 034-99	US$	52	180
Bonos TP - Temporal portfolio exchange	D.S. 114-98-EF	US$	136	98
Bonos TP - Debt exchange bonds	D.S. 068-99-EF	US$	259	634
Bonos TP - RFA and FOPE programs	D.S. 059-2000-EF / D.U. 050-20(	US$	108	376
Bonos TP - Financial system consolidation	D.U. 108-2000	US$	392	1,348
Bonos TP - Sovereign bonds	D.U. 015-2001 / D.U. 106-2001	S/.	3,645	2,660
Bonos TP - Caja de Pensiones Militar Policial Bonds	D.U. 030-2001	US$	34	117
Treasury Bills	D.U. 010-2003	S/.		200
Total				**10,227**
Memorandum items:				
Pension Reform Bonds (Bonos de Reconocimiento)	D.S. 096-95-EF	S/.		9,734
Floating debt		S/.		1,485

Press Release No. 04/112
FOR IMMEDIATE RELEASE
June 9, 2004

International Monetary Fund
Washington, D.C. 20431 USA

IMF Approves 26-month US$422.8 Million Stand-By Arrangement for Peru

The Executive Board of the International Monetary Fund (IMF) today approved a 26-month SDR 287.3 million (about US$422.8 million) Stand-By Arrangement for Peru to support the country's economic program through mid-2006. The approval enables the release of a first drawing of SDR 80 million (about US$118 million) under the arrangement. However, the authorities have indicated their intention to treat this arrangement as precautionary.

Following the Executive Board discussion, on Peru, Rodrigo de Rato, Managing Director and Chairman of the Board, said:

"Peru's recent economic performance has been favorable, with solid growth and low inflation. Substantial buffers, including a high level of international reserves and a well-capitalized banking system, have been built up to further reduce vulnerabilities associated with high dollarization and public debt, and there has been progress with structural reforms.
The authorities' program for 2004-06 aims at consolidating macroeconomic stability, fortifying confidence, strengthening the basis for sustainable growth and employment creation so as to reduce poverty, and further reducing financial vulnerabilities. It focuses on the consistent implementation of their inflation-targeting framework and on fiscal consolidation, with a view to continue improving public debt dynamics and increasing the scope for priority social and infrastructure investment.

"The program also includes a broad set of growth-enhancing reforms aimed at reducing the high levels of unemployment and poverty. In 2004, the authorities plan to foster private investment by establishing commercial courts and improving collateral registries. They also plan to grant operating concessions to the private sector and enter into targeted public-private partnerships (PPPs), which will be implemented in a prudent manner and accounted for transparently in the budget. The reform program will also improve public resource management, modify public pension regimes—including the preferential *Cédula Viva*—reduce labor costs, and strengthen bank supervision and the legal framework for fiscal decentralization.

"The authorities' firm commitment to implementing prudent economic polices in the context of a challenging political and social environment is commendable. Strengthening political consensus for critical reforms will be crucial to press forward with the reform momentum of recent years and reduce the vulnerabilities facing the economy and reinforce confidence in the continuity of

prudent policies. This will help boost broad-based and sustainable growth and employment and reduce poverty, while strengthening the basis for Peru's successful exit from the series of Fund-supported programs," the Managing Director said.

Recent economic developments

Peru made progress in stabilizing its economy and adopting growth-enhancing structural reforms, under the 2002–03 Stand-By Arrangement with the Fund. Economic growth averaged 4.5 percent a year, inflation remained low under the inflation targeting framework of the central bank, and substantial buffers were built to mitigate financial vulnerabilities. These buffers included a high level of international reserves and a well-capitalized banking system. Progress was also made in structural reforms, including in the areas of decentralization, pension reform, clarifying fiscal rules, strengthening the financial system, and reorienting the privatization program towards granting concessions.

In 2003, Peru's GDP grew by 4 percent in real terms and inflation was limited to 2.5 percent. Fiscal consolidation was in line with the government's target—the deficit of the combined public sector was reduced from 2.2 percent of GDP in 2002 to 1.7 percent of GDP. Revenues were boosted by tax measures introduced in mid 2002 and mid 2003. Peru's external position also strengthened in 2003 and financial indicators improved. The external current account deficit fell from more than 2 percent of GDP in 2002 to about 1.75 percent, driven by commodity export growth. Private capital inflows remained strong, particularly foreign direct investment in the natural resource sector. Gross international reserves rose by about US$500 million during 2003 and by a further US$250 million during the first four months of 2004, to US$10.5 billion at end-April 2004. The Lima stock exchange index surged by 75 percent during 2003, reflecting higher mineral product prices. Peru's sovereign spread continues to be among the lowest in the region.

Program summary

The objectives of the program for 2004–2006 are to maintain macroeconomic stability, foster robust growth and employment, further reduce vulnerabilities, and diminish poverty.
The program aims at enhancing the basis for strong economic growth, which is projected to average about 4.5 percent a year during 2004–06. It focuses on the continued implementation of the inflation-targeting framework and on fiscal consolidation, with a view to lowering the debt-to-GDP ratio from about 47.5 percent in 2003 to about 41 percent in 2006. Successful implementation of the program will enhance the basis for defining Peru's exit strategy from Fund supported programs.

The **fiscal program** is based on reducing the overall deficit of the combined public sector from 1.7 percent of GDP in 2003 to 1.4 percent in 2004, and to 1 percent a year in 2005–06. Over this period, about one third of the adjustment effort of the central government is to be achieved through higher revenue, and the remainder through a containment in current expenditure growth.
Monetary policy will continue to be managed within the inflation-targeting framework.
While preserving its floating in the exchange rate regime, the authorities intend to maintain a

solid cushion of foreign reserves to mitigate potential external shocks and political uncertainties in the period up to the 2006 elections.

Boosting economic growth and employment creation depends critically on the sustained implementation of a broad set of reforms. The program includes **growth enhancing reforms** aimed at strengthening the investment climate, including the establishment of commercial courts to speed up contract enforcement and improvements in the functioning of collateral registries. To bolster infrastructure investment, the authorities plan to grant operating concessions to the private sector and enter into Public-Private Partnerships in a fiscally prudent and transparent manner. Also, the authorities intend to improve resource management in the public sector, modify public pension regimes, reduce labor costs, and strengthen the legal framework for decentralization. The program includes efforts aimed at further strengthening the regulation and supervision of financial intermediaries.

Peru joined the IMF on December 31, 1945, and its current quota is SDR 638.4 million (about US$939 million). Its outstanding use of IMF financing currently totals SDR 80.3 million (about US$118 million).

Peru: Selected Economic Indicators

	2002	Est. 2003	Proj. 2004	Proj. 2005	Proj. 2006
	(Annual percentage change, unless otherwise indicated)				
Real economy					
Real GDP	4.9	4.0	4.0	4.5	4.5
Inflation 1/	1.5	2.5	2.5	2.5	2.5
Terms of trade	2.5	2.5	9.1	-0.9	-0.1
Real effective exchange rate (depreciation -) 1/ 2/	-5.5	-10.7	...	...	...
Nominal exchange rate (in soles per U.S. dollar) 1/	3.51	3.47	...	...	...
Money and credit					
Base money	11.0	10.1	8.0	8.0	8.0
Liabilities to the private sector 3/ 4/	8.7	13.5	9.3	11.3	11.8
Credit to private sector 3/ 4/	2.1	3.7	3.1	4.8	4.6
	(In percent of GDP, unless otherwise indicated)				
Savings and investment					
Gross domestic investment	18.4	18.5	18.2	18.6	18.9
National savings	16.3	16.7	17.5	17.8	18.2
External savings	2.1	1.8	0.7	0.8	0.7
Balance of payments					
Current account	-2.1	-1.8	-0.7	-0.8	-0.7
Capital and financial account	3.5	2.5	0.8	0.9	0.8
Gross official reserves (in months of imports of goods and services) 1/	10.5	10.5	10.1	9.5	9.2
Gross official reserves (in percent of broad money) 1/	65.2	67.7	66.9	68.2	69.6
Public sector					
Combined public sector primary balance	0.0	0.4	0.8	1.4	1.5
Combined public sector overall balance	-2.2	-1.7	-1.4	-1.0	-1.0
Public sector medium-and long-term external debt	36.9	37.3	35.4	34.7	33.1

Sources: Central Reserve Bank of Peru; and IMF Staff estimates and projections.

1/ At end period.
2/ Based on the Information Notice System.
3/ Flows in foreign currency are valued at program exchange rate.
4/ Corresponds to the financial system.

Statement by Guillermo Le Fort, Executive Director for Peru and Carlos E. Pereyra, Senior Advisor to Executive Director June 9, 2004

1. Under the 2002-2003 Stand-By Arrangement (SBA), growth accelerated significantly, inflation was kept within the target, and there were considerable advances in fiscal consolidation and structural reform. Going forward, the authorities' goals are to further diminish vulnerabilities, improve competitiveness, reinforce investor sentiment, and reduce the poverty level while maintaining macroeconomic stability. The Peruvian authorities recognize the importance of close collaboration with the Fund to successfully tackle these challenges; in particular, they value the sound technical advice, as well as the greater international credibility associated with Fund endorsement. In view of these considerations, the authorities see the convenience of requesting a successor SBA covering the period through August 16, 2006, also to be treated as precautionary. The authorities' policy agenda is described in the Memorandum of Economic and Financial Policies (MEFP) and reflects broad-based consultation.

Macroeconomic Policies

2. The results as of the first quarter of 2004 confirm the positive trend in the main macroeconomic variables. Annual GDP growth was 4.6 percent, and is projected at 4 percent for the year. Export growth —roughly 30 percent in US$ terms— was underpinned by favorable commodity prices and by a continuous expansion in the volume of industrial exports, mainly textiles and agricultural goods. Growth in domestic demand is also sustained. While consumption increased at around 3 percent, growth in private investment accelerated, reaching 8 percent in the first quarter, the highest rate since end-1997. Moreover, preliminary information shows that during the first quarter Peru posted a fiscal surplus of 0.7 percent of GDP —and a primary surplus of 3.3 percent of GDP— which reflects the process of fiscal consolidation resulting from prudent policies. Monetary policy continues to meet the inflation target, while the level of reserves stood at a comfortable level —2.3 times short-term debt— and has since continued to increase. Overall, the medium-term outlook remains positive, supported by good prospects for the international environment and ample access to foreign financing. After reaching historical low levels at the beginning of the year, sovereign spreads have increased somewhat lately, due to a correction in expectations regarding international interest rates. However, end-May levels were similar to those in mid-2003, and remain among the lowest in Latin America.

3. The macroeconomic framework proposed for 2004-2006 is geared to strengthen the fiscal and external positions achieved under the 2002-2003 SBA, while locking in the growth momentum and the low inflation rate. On the fiscal front, the authorities will further strengthen debt sustainability, with public debt falling from over 47 percent of GDP last year to almost 40 percent of GDP at end-2006. Towards this goal, the overall public sector deficit is to be cut from 1.7 percent of GDP in 2003 to 1.4 percent in 2004 and to 1 percent in both 2005 and 2006. The authorities will persevere in enhancing revenues, exerting expenditure restraint and improving its quality and focus. Central government

tax revenues are expected to rise, mainly reflecting higher income tax collections associated with buoyant export prices, the continuation of administration improvements, and the tax reform completed in early 2004.

4. As anticipated in the last Board meeting, for 2004 the Financial Transaction Tax (FTT) rate has been reduced from 0.15 percent to 0.10 percent, and will be gradually phased out, with rates falling to 0.08 percent in 2005 and 0.06 percent in 2006. The authorities also intend to devote revenues accruing from the FTT primarily to attend priority needs, including social spending in health and education, as well as infrastructure and security. Moreover, they will continue to work in coordination with regional governments and Congress to gradually eliminate sectoral and regional tax exemptions to generate additional resources for infrastructure and social services in the regions. The authorities will also explore financial mechanisms to enhance public investment, given its key role in social and productive development, in a way that is fully consistent with fiscal targets and debt sustainability.

5. Reflecting improved investor sentiment, Peru has maintained its access to international capital markets. Recently, Fitch international rating agency revised the outlook on Peru's long-term foreign currency rating from Stable to Positive, in response to improved public and external finances and reduced public financing vulnerabilities. In April, the government launched a US$ 500 million 12-year global bond —including CACs— which completed its financing needs from the capital markets for 2004. This issue is also part of the government's plan to improve medium-term fiscal sustainability by extending the term of Peru's foreign debt profile. The strategy includes expanding placements in medium- and long-term local currency instruments to reduce rollover and currency risks. As previously reported, towards this end the authorities have successfully developed a primary dealer system since March 2003.

6. The inflation targeting scheme adopted in 2002 aims at a 2.5 percent medium-term inflation target within a ±1 percent range, in the context of a floating exchange rate regime. Recently, supply shocks, mainly weak agricultural crops and increases in world oil prices, generated a rise in inflation towards the upper end of target range. However, given the temporary nature of these pressures, inflation is expected to converge towards the center of the target band in the rest of the year and without the need of tightening monetary policy. The authorities stand ready to take the necessary steps to ensure the achievement of the inflation target.

7. Consistent with the inflation targeting framework, the Central Reserve Bank of Peru maintains a floating exchange rate regime, with interventions in the foreign exchange market limited to those needed to confront excessive exchange rate volatility or abrupt fluctuations, without any implicit or explicit commitment to any given exchange rate level. This flexibility allows the independent monetary policy —whereby the central bank adjusts domestic liquidity and the interest rate— to be directed to achieve the inflation target. This policy setting has been successful in meeting the inflation target and has also resulted in low interest rate volatility in the interbank market in domestic currency.

Structural Reforms

8. The authorities will continue their plans to implement key structural reforms aimed to ensure sustained and balanced growth. This year they relaunched their plans to promote private sector investment in infrastructure, and intend to step-up their efforts in this field through public-private partnerships (PPPs) and other arrangements. The government has recently signed a long-term management contract for a hydroelectric plant, sold its stake in an oil refinery, and completed the concession of an irrigation project. Their plans for the near future include granting in concession two major mining projects, as well as the operation and maintenance of a port terminal. With the aim of overhauling the road network, the government will award concessions or engage in PPPs for the construction and maintenance of at least two major roads by end-2004. All outlays or contingent liabilities associated with these arrangements will be reflected transparently in the budgetary and debt accounts. The authorities are confident in succeeding to muster support for the program, including by involving regional and local governments in the process.

9. In May, Congress concluded the first of two voting rounds needed for a constitutional amendment to close the preferential pension regime (*Cedula Viva*) —which has undergone modifications previously, but remains highly inequitable and requires heavy subsidization from central government current spending. The proposal, which enjoys broad political support, will include centralizing the administration of the system and eliminating the costly link between wage increases and pensions. Savings from the reform will contribute to more efficient expenditure allocation and support the reform of the state.

10. Within the reform of the state, the government is working to implement a computerized payroll, as well as a census of employees and pensioners. The authorities will continue to modernize procurement procedures and improve the regulation of domestic fuel prices. Increasing the effectiveness of social expenditure and improving the targeting of poverty-reducing programs, with the assistance of the Inter-American Development Bank (IADB) and the World Bank, remain at the core of the authorities' agenda.

11. The authorities are engaged in actively pursuing regional and bilateral free-trade agreements (FTAs). In particular, Peru has started negotiations for an FTA with the U.S., which would make permanent the special access to the U.S. market currently enjoyed under the Andean Trade Promotion and Drug Eradication Act (ATPDEA). The FTA is also expected to encourage export diversification, as well as accelerate critical reforms that will attract investment to the region. At the same time, the authorities remain committed to participating in the FTAA initiative.

12. In this context, improving the business climate is a priority. Thus, the establishment of commercial courts modules to resolve commercial disputes and speed-up contract enforcement is an important part of the program to strengthen property rights.

13. The authorities are committed to complete the legal framework for decentralization to ensure that the devolution process is implemented in an orderly, gradual, and fiscally

neutral manner. Fundamentally, by end-year the government will submit to Congress draft laws to establish the criteria to certify sub-national governments' administrative capacity to deliver essential public services; clarify the distribution of functional responsibilities among the different levels of government; and specify remedial measures for sub-national governments that do not comply with the fiscal rules established under the Fiscal Decentralization Law.

14. Financial system indicators remain sound as a result of a consistent strengthening of financial regulation and supervision. In 2004, the authorities will further strengthen financial sector regulations and supervision, including in the context of the new Basle regulations, promote dedollarization, and support the development of domestic capital markets to increase the access and quality of credit, including through strengthening the basis for collateralization.

On the Program

15. The authorities are fully aware of the need to further advance the reform process, particularly in key areas including fiscal consolidation, financial de-dollarization, and growth-enhancing structural reforms. In their view, the proposed SBA, with the associated policy advice, direct dialogue, and explicit endorsement, would significantly contribute to achieving these goals.

16. Like previously, the authorities intend to treat the proposed SBA as precautionary, keeping the Fund's financial exposure in Peru at a minimum —currently only 12.6 percent of quota. The proposed arrangement presents a more complete conditionality structure, including two structural performance criteria, with the aim of improving competitiveness and press forward with institutional reform. Also, the authorities underscore that the key policies that would be undertaken under the proposed program would pave the way for an exit strategy from Fund-supported programs.